APPENDIX G: IASB PROPOSED IFRS, *SHARE-BASED PAYMENT*

(Please Note: The pages that follow in this appendix are not numbered consecutively as part of the Invitation to Comment. The next consecutive page number will be 237 in Appendix H.)

Exposure Draft

ED 2 SHARE-BASED PAYMENT

Comments to be received by 7 March 2003

ED 2 *Share-based Payment* is published by the International Accounting Standards Board (IASB) for comment only. The proposals may be modified in the light of the comments received before being issued as an International Financial Reporting Standard (IFRS). Comments on the draft IFRS and its accompanying documents (see separate booklets) should be submitted in writing so as to be received by **7 March 2003**.

All replies will be put on the public record unless confidentiality is requested by the commentator. 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.uk** or addressed to:

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Share-based Payment

INVITATION TO COMMENT

The International Accounting Standards Board invites comments on any aspect of this Exposure Draft of its proposed IFRS *Share-based Payment.* It would particularly welcome answers to the questions set out below. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

Comments should be submitted in writing so as to be received no later than **7 March 2003**.

Question 1

Paragraphs 1-3 of the draft IFRS set out the proposed scope of the IFRS. There are no proposed exemptions, apart from for transactions within the scope of another IFRS.

Is the proposed scope appropriate? If not, which transactions should be excluded and why?

Question 2

Paragraphs 4-6 of the draft IFRS propose requirements for the recognition of share-based payment transactions, including the recognition of an expense when the goods or services received or acquired are consumed.

Are these recognition requirements appropriate? If not, why not, or in which circumstances are the recognition requirements inappropriate?

Question 3

For an equity-settled share-based payment transaction, the draft IFRS proposes that, in principle, the entity should measure the goods or services received, and the corresponding increase in equity, either directly, at the fair value of the goods or services received, or indirectly, by reference to the fair value of the equity instruments granted, whichever fair value is more readily determinable (paragraph 7). There are no exemptions to the requirement to measure share-based payment transactions at fair value. For example, there are no exemptions for unlisted entities.

Is this measurement principle appropriate? If not, why not, or in which circumstances is it not appropriate?

Question 4

If the fair value of the goods or services received in an equity-settled share-based payment transaction is measured directly, the draft IFRS proposes that fair value should be measured at the date when the entity obtains the goods or receives the services (paragraph 8).

Do you agree that this is the appropriate date at which to measure the fair value of the goods or services received? If not, at which date should the fair value of the goods or services received be measured? Why?

Question 5

If the fair value of the goods or services received in an equity-settled share-based payment transaction is measured by reference to the fair value of the equity instruments granted, the draft IFRS proposes that the fair value of the equity instruments granted should be measured at grant date (paragraph 8).

Do you agree that this is the appropriate date at which to measure the fair value of the equity instruments granted? If not, at which date should the fair value of the equity instruments granted be measured? Why?

Question 6

For equity-settled transactions with parties other than employees, the draft IFRS proposes a rebuttable presumption that the fair value of the goods or services received is more readily determinable than the fair value of the equity instruments granted (paragraphs 9 and 10).

Do you agree that the fair value of the goods or services received is usually more readily determinable than the fair value of the equity instruments granted? In what circumstances is this not so?

Question 7

For equity-settled transactions with employees, the draft IFRS proposes that the entity should measure the fair value of the employee services received by reference to the fair value of the equity instruments granted, because the latter fair value is more readily determinable (paragraphs 11 and 12).

Do you agree that the fair value of the equity instruments granted is more readily determinable than the fair value of the employee services received? Are there any circumstances in which this is not so?

Question 8

Paragraphs 13 and 14 of the draft IFRS propose requirements for determining when the counterparty renders service for the equity instruments granted, based on whether the counterparty is required to complete a specified period of service before the equity instruments vest.

Do you agree that it is reasonable to presume that the services rendered by the counterparty as consideration for the equity instruments are received during the vesting period? If not, when are the services received, in your view?

Question 9

If the services received are measured by using the fair value of the equity instruments granted as a surrogate measure, the draft IFRS proposes that the entity should determine the amount to attribute to each unit of service received, by dividing the fair value of the equity instruments granted by the number of units of service expected to be received during the vesting period (paragraph 15).

Do you agree that if the fair value of the equity instruments granted is used as a surrogate measure of the fair value of the services received, it is necessary to determine the amount to attribute to each unit of service received? If not, what alternative approach do you propose? If an entity is required to determine the amount to attribute to each unit of service received, do you agree that this should be calculated by dividing the fair value of the equity instruments granted by the number of units of services expected to be received during the vesting period? If not, what alternative method do you propose?

Question 10

In an equity-settled share-based payment transaction, the draft IFRS proposes that having recognised the services received, and a corresponding increase in equity, the entity should make no subsequent adjustment to total equity, even if the equity instruments granted do not vest or, in the case of options, the options are not exercised (paragraph 16). However, this requirement does not preclude the entity from recognising a transfer within equity, ie a transfer from one component of equity to another.

Do you agree with this proposed requirement? If not, in what circumstances should an adjustment be made to total equity and why?

Question 11

The draft IFRS proposes that the entity should measure the fair value of equity instruments granted, based on market prices if available, taking into account the terms and conditions of the grant (paragraph 17). In the absence of a market price, the draft IFRS proposes that the entity should estimate the fair value of options granted, by applying an option pricing model that takes into account various factors, namely the exercise price of the option, the life of the option, the current price of the underlying shares, the expected volatility of the share price, the dividends expected on the shares (where appropriate) and the risk-free interest rate for the life of the option (paragraph 20). Paragraph 23 of the proposed IFRS explains when it is appropriate to take into account expected dividends.

Do you agree that an option pricing model should be applied to estimate the fair value of options granted? If not, by what other means should the fair value of the options be estimated? Are there circumstances in which it would be inappropriate or impracticable to take into account any of the factors listed above in applying an option pricing model?

Question 12

If an option is non-transferable, the draft IFRS proposes that the expected life of an option rather than its contracted life should be used in applying an option pricing model (paragraph 21). The draft IFRS also proposes requirements for options that are subject to vesting conditions and therefore cannot be exercised during the vesting period (paragraph 22).

Do you agree that replacing an option's contracted life with its expected life when applying an option pricing model is an appropriate means of adjusting the option's fair value for the effects of non-transferability? If not, do you have an alternative suggestion? Is the proposed requirement for taking into account the inability to exercise an option during the vesting period appropriate?

Question 13

If a grant of shares or options is conditional upon satisfying specified vesting conditions, the draft IFRS proposes that these conditions should be taken into account when an entity measures the fair value of the shares or options granted. In the case of options, vesting conditions should be taken into account either by incorporating them into the application of an option pricing model or by making an appropriate adjustment to the value produced by such a model (paragraph 24).

Do you agree that vesting conditions should be taken into account when estimating the fair value of options or shares granted? If not, why not? Do you have any suggestions for how vesting conditions should be taken into account when estimating the fair value of shares or options granted?

Question 14

For options with a reload feature, the draft IFRS proposes that the reload feature should be taken into account, where practicable, when an entity measures the fair value of the options granted. However, if the reload feature is not taken into account in the measurement of the fair value of the options granted, then the reload option granted should be accounted for as a new option grant (paragraph 25).

Is this proposed requirement appropriate? If not, why not? Do you have an alternative proposal for dealing with options with reload features?

Question 15

The draft IFRS proposes requirements for taking into account various features common to employee share options, such as non-transferability, inability to exercise the option during the vesting period, and vesting conditions (paragraphs 21-25).

Are there other common features of employee share options for which the IFRS should specify requirements?

Question 16

The draft IFRS does not contain prescriptive guidance on the estimation of the fair value of options, consistently with the Board's objective of setting principles-based standards and to allow for future developments in valuation methodologies.

Do you agree with this approach? Are there specific aspects of valuing options for which such guidance should be given?

Question 17

If an entity reprices a share option, or otherwise modifies the terms or conditions on which equity instruments were granted, the draft IFRS proposes that the entity should measure the incremental value granted upon repricing, and include that incremental value when measuring the services received. This means that the entity is required to recognise additional amounts for services received during the remainder of the vesting period, ie additional to the amounts recognised in respect of the original option grant. Example 3 in Appendix B illustrates this requirement. As shown in that example, the incremental value granted on repricing is treated as a new option grant, in addition to the original option grant. An alternative approach is also illustrated, whereby the two grants are averaged and spread over the remainder of the vesting period.

Do you agree that the incremental value granted should be taken into account when measuring the services received, resulting in the recognition of additional amounts in the remainder of the vesting period? If not, how do you suggest repricing should be dealt with? Of the two methods illustrated in Example 3, which is more appropriate? Why?

Question 18

If an entity cancels a share or option grant during the vesting period (other than a grant cancelled by forfeiture when the vesting conditions are not satisfied), the draft IFRS proposes that the entity should continue to recognise the services rendered by the counterparty in the remainder of the vesting period, as if that grant had not been cancelled. The draft IFRS also proposes requirements for dealing with any payment made on cancellation and/or a grant of replacement options, and for the repurchase of vested equity instruments.

Are the proposed requirements appropriate? If not, please explain why not and provide details of your suggested alternative approach.

Question 19

For cash-settled share-based payment transactions, the draft IFRS proposes that the entity should measure the goods or services acquired and the liability incurred at the fair value of the liability. Until the liability is settled, the entity should remeasure the fair value of the liability at each reporting date, with any changes in value recognised in the income statement.

Are the proposed requirements appropriate? If not, please provide details of your suggested alternative approach.

Question 20

For share-based payment transactions in which either the entity or the supplier of goods or services may choose whether the entity settles the transaction in cash or by issuing equity instruments, the draft IFRS proposes that the entity should account for the transaction, or the components of that transaction, as a cash-settled share-based payment transaction if the entity has incurred a liability to settle in cash, or as an equity-settled share-based payment transaction if no such liability has been incurred. The draft IFRS proposes various requirements to apply this principle.

Are the proposed requirements appropriate? If not, please provide details of your suggested alternative approach.

Question 21

The draft IFRS proposes that an entity should disclose information to enable users of financial statements to understand:

(a) the nature and extent of share-based payment arrangements that existed during the period,

(b) how the fair value of the goods or services received, or the fair value of the equity instruments granted, during the period was determined, and

(c) the effect of expenses arising from share-based payment transactions on the entity's profit or loss.

Are these disclosure requirements appropriate? If not, which disclosure requirements do you suggest should be added, deleted or amended (and how)?

Question 22

The draft IFRS proposes that an entity should apply the requirements of the IFRS to grants of equity instruments that were granted after the publication date of this Exposure Draft and had not vested at the effective date of the IFRS. It also proposes that an entity should apply retrospectively the requirements of the IFRS to liabilities existing at the effective date of the IFRS, except that the entity is not required to measure vested share appreciation rights (and similar liabilities) at fair value, but instead should measure such liabilities at their settlement amount (ie the amount that would have been paid on settlement of the liability had the counterparty demanded settlement at the date the liability is measured).

Are the proposed requirements appropriate? If not, please provide details of your suggestions for the IFRS's transitional provisions.

Question 23

The draft IFRS proposes a consequential amendment to IAS 12 (revised 2000) *Income Taxes* to add an example to that standard illustrating how to account for the tax effects of share-based payment transactions. As shown in that example, it is proposed that all tax effects of share-based payment transactions should be recognised in the income statement.

Are the proposed requirements appropriate?

Question 24

In developing the Exposure Draft, the Board considered how various issues are dealt with under the US standard SFAS 123 *Accounting for Stock-Based Compensation*, as explained further in the Basis for Conclusions. Although the draft IFRS is similar to SFAS 123 in many respects, there are some differences. The main differences include the following.

(a) Apart from transactions within the scope of another IFRS, the draft IFRS does not propose any exemptions, either from the requirement to apply the IFRS or from the requirement to measure share-based payment transactions at fair value. SFAS 123 contains the following exemptions, none of which are included in the draft IFRS:

- employee share purchase plans are excluded from SFAS 123, provided specified criteria are met, such as the discount given to employees is relatively small;
- SFAS 123 encourages, but does not require, entities to apply its fair value measurement method to recognise transactions with employees; entities are permitted to apply instead the intrinsic value measurement method in Accounting Principles Board Opinion No. 25 *Accounting for Stock Issued to Employees* (paragraphs BC70-BC74 in the Basis for Conclusions give an explanation of intrinsic value); and
- unlisted (non-public) entities are permitted to apply the minimum value method when estimating the value of share options, which excludes from the valuation the effects of expected share price volatility (paragraphs BC75-BC78 in the Basis for Conclusions give an explanation of minimum value).

(b) For transactions in which equity instruments are granted to employees, both SFAS 123 and the draft IFRS have a measurement method that is based on the fair value of those equity instruments at grant date. However:

- under SFAS 123, the estimate of the fair value of an equity instrument at grant date is not reduced for the possibility of forfeiture due to failure to satisfy the vesting conditions, whereas the draft IFRS proposes that the possibility of forfeiture should be taken into account in making such an estimate.
- under SFAS 123, the transaction is measured at the fair value of the equity instruments issued. Because equity instruments are not regarded as issued until any specified vesting conditions have been satisfied, the transaction amount is ultimately measured at the number of vested equity instruments multiplied by the fair value of those equity instruments at grant date. Hence, any amounts recognised for employee services received during the vesting period will be subsequently reversed if the equity instruments granted are forfeited. Under the draft IFRS, the transaction is measured at the deemed fair value of the employee services received. The fair value of the equity instruments granted is used as a surrogate measure, to determine the deemed fair value of each unit of employee service received. The transaction amount is ultimately measured at the number of units of service received during the vesting period multiplied by the deemed fair value per unit of service. Hence, any amounts recognised for employee services received are not subsequently reversed, even if the equity instruments granted are forfeited.

(c) If, during the vesting period, an entity settles in cash a grant of equity instruments, under SFAS 123 those equity instruments are regarded as having immediately vested, and therefore the amount of compensation expense measured at grant date but not yet recognised is recognised immediately at the date of settlement. The draft IFRS does not require immediate recognition of an expense but instead proposes that the entity should continue to recognise the services received (and hence the resulting expense) over the remainder of the vesting period, as if that grant of equity instruments had not been cancelled.

(d) SFAS 123 does not specify a measurement date for transactions with parties other than employees that are measured at the fair value of the equity instruments issued. Emerging Issues Task Force Issue 96-18 *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services* requires the fair value of the equity instruments issued to be measured at the earlier of (i) the date a performance commitment is reached or (ii) the date performance is complete. This date might be later than grant date, for example, if there is no performance commitment at grant date. Under the draft IFRS, the fair value of the equity instruments granted is measured at grant date in all cases.

(e) SFAS 123 requires liabilities for cash-settled share appreciation rights (SARs) to be measured using an intrinsic value measurement method. The draft IFRS proposes that such liabilities should be measured using a fair value measurement method, which includes the time value of the SARs, in the same way that options have time value (refer to paragraphs BC70-BC81 of the Basis for Conclusions for a discussion of intrinsic value, time value and fair value).

(f) For a share-based payment transaction in which equity instruments are granted, SFAS 123 requires realised tax benefits to be credited direct to equity as additional paid-in capital, to the extent that those tax benefits exceed the tax benefits on the total amount of compensation expense recognised in respect of that grant of equity instruments. The draft IFRS, in a consequential amendment to IAS 12 (revised 2000) *Income Taxes*, proposes that all tax effects of share-based payment transactions should be recognised in profit or loss, as part of tax expense.

For each of the above differences, which treatment is the most appropriate? Why? If you regard neither treatment as appropriate, please provide details of your preferred treatment.

(Respondents may wish to note that further details of the differences between the draft IFRS and SFAS 123 are given in the FASB's Invitation to Comment.)

Question 25

Do you have any other comments on the Exposure Draft?

[Draft] International Financial Reporting Standard X *Share-based Payment* ([draft] IFRS X) is set out in paragraphs 1-56, Appendices A-E and the Glossary. All the paragraphs have equal authority. The scope and authority of IFRSs are explained in the *Preface to International Financial Reporting Standards*. Terms listed in Appendix A are defined in the Glossary and are set in *italics* the first time they appear in the [draft] IFRS. [Draft] IFRS X is accompanied by a Basis for Conclusions and implementation guidance. [Draft] IFRS X should be read in the context of its objective and the *Framework for the Preparation and Presentation of Financial Statements,* which provide a basis for selecting and applying accounting policies in the absence of explicit guidance.

INTRODUCTION

Objective

I1 The objective of [draft] IFRS X *Share-based Payment* is to ensure that an entity recognises all share-based payment transactions in its financial statements, measured at fair value, so as to provide high quality, transparent and comparable information to users of financial statements.

Main features of this [draft] IFRS

I2 The [draft] IFRS requires an entity to recognise all share-based payment transactions in its financial statements, including transactions to be settled in cash, other assets, or equity instruments of the entity, and transactions with employees or other parties. There are no exceptions to the [draft] IFRS, other than for transactions to which more specific standards apply. For example, there is no exception for employee share purchase plans.

I3 The [draft] IFRS sets out measurement principles and specific requirements for three types of share-based payment transactions:

(a) equity-settled share-based payment transactions, in which the entity receives goods or services as consideration for equity instruments of the entity (including shares or share options);

(b) cash-settled share-based payment transactions, in which the entity acquires goods or services by incurring liabilities to the supplier of those goods or services for amounts that are based on the price (or value) of the entity's shares or other equity instruments; and

(c) transactions in which the entity receives or acquires goods or services and either the entity or the supplier of those goods or services may choose whether the entity settles the transaction in cash, in amounts that are based on the price (or value) of the entity's shares or other equity instruments, or by issuing equity instruments.

I4 For equity-settled share-based payment transactions, the [draft] IFRS requires an entity to measure the fair value of the goods or services received, and the corresponding increase in equity, either directly, at the fair value of the goods or services received, or indirectly, by reference to

the fair value of the equity instruments granted, whichever fair value is more readily determinable. Furthermore:

(a) if the fair value of the goods or services received is measured directly, fair value is measured at the date the entity obtains the goods or receives the services. If the fair value of the goods or services received is measured by using the fair value of the equity instruments granted as a surrogate measure, fair value is measured at grant date.

(b) for transactions with parties other than employees, there is a rebuttable presumption that the fair value of the goods or services received is more readily determinable. For transactions with employees, the entity is required to measure the fair value of the equity instruments granted, because that is more readily determinable than the fair value of employee services received.

(c) if the services received are measured by reference to the fair value of the equity instruments granted, the [draft] IFRS specifies a method by which the entity should determine the amount to attribute to each unit of service received. This deemed fair value per unit of service is then applied to the number of units of service received during the vesting period. If a counterparty ceases to render service during the vesting period, no further amounts are recognised in respect of that counterparty's service, but neither are amounts recognised previously reversed. Thus, the transaction amount represents the total services received from the counterparty as consideration for equity instruments of the entity, irrespective of whether those equity instruments are subsequently forfeited or, in the case of options, are not exercised.

(d) the [draft] IFRS requires the fair value of equity instruments granted to be based on market prices, if available, and to take into account the terms and conditions upon which those equity instruments were granted. In the absence of market prices, fair value is estimated. In the case of options, the entity is required to apply an option pricing model. The [draft] IFRS sets out requirements for incorporating into the fair value estimate common features of employee share options, such as non-transferability, inability to exercise the option during the vesting period and vesting conditions (including service conditions and performance conditions).

(e) the [draft] IFRS also sets out requirements if the terms and conditions of an option or share are modified (eg an option is repriced) or if a grant is cancelled, repurchased and/or replaced with another grant of equity instruments.

I5 For cash-settled share-based payment transactions, the [draft] IFRS requires an entity to measure the goods or services acquired and the liability incurred at the fair value of the liability. Until the liability is settled, the entity is required to remeasure the fair value of the liability at each reporting date, with any changes in value recognised in profit or loss.

I6 For share-based payment transactions in which either the entity or the supplier of goods or services may choose whether the entity settles the transaction in cash or by issuing equity instruments, the entity is required to account for that transaction, or the components of that transaction, as a cash-settled share-based payment transaction if the entity has incurred a liability to settle in cash, or as an equity-settled share-based payment transaction if no such liability has been incurred.

I7 The [draft] IFRS specifies various disclosure requirements to enable users of financial statements to understand:

(a) the nature and extent of share-based payment arrangements that existed during the period;

(b) how the fair value of the goods or services received, or the fair value of the equity instruments granted, during the period was determined; and

(c) the effect of expenses arising from share-based payment transactions on the entity's profit or loss.

[DRAFT] INTERNATIONAL FINANCIAL REPORTING STANDARD IFRS X

Share-based Payment

SCOPE

1 An entity shall apply this [draft] IFRS in accounting for all *share-based payment transactions*, including:

(a) *equity-settled share-based payment transactions*, in which the entity receives goods or services as consideration for *equity instruments* of the entity (including shares or *share options*),

(b) *cash-settled share-based payment transactions*, in which the entity acquires goods or services by incurring liabilities to the supplier of those goods or services for amounts that are based on the price (or value) of the entity's shares or other equity instruments, and

(c) transactions in which the entity receives or acquires goods or services and either the entity or the supplier of those goods or services may choose whether the entity settles the transaction in cash, in amounts that are based on the price (or value) of the entity's shares or other equity instruments, or by issuing equity instruments

except as noted in paragraph 3.

2 For the purposes of this [draft] IFRS, transfers of an entity's equity instruments by its shareholders, or transfers of equity instruments of the entity's parent or of another entity in the same group as the entity, to the entity's employees, or to other parties that have supplied goods or services to the entity, are share-based payment transactions, unless the transfer is clearly for a purpose other than payment for goods or services supplied to the entity.

3 As noted in paragraph 1, this [draft] IFRS applies to share-based payment transactions in which an entity acquires or receives goods or services. Goods includes inventories, consumables, property, plant and equipment, intangible assets and other non-financial assets. However, an entity shall not apply this [draft] IFRS to transactions in which the entity:

(a) acquires goods or other non-financial assets as part of the net assets acquired in a business combination to which IAS 22 [IFRS X] *Business Combinations* applies, or

(b) receives or acquires goods or services pursuant to a contract within the scope of paragraph 4A or 4B of IAS 32 [revised 200X] *Financial Instruments: Disclosure and Presentation* or paragraph 6 or 7 of IAS 39 [revised 200X] *Financial Instruments: Recognition and Measurement*.

RECOGNITION

4 **An entity shall recognise the goods or services received or acquired in a share-based payment transaction when it obtains the goods or as the services are received. The entity shall recognise a corresponding increase in equity if the goods or services were received in an equity-settled share-based payment transaction, or a liability if the goods or services were acquired in a cash-settled share-based payment transaction.**

5 **When the goods or services received or acquired in a share-based payment transaction do not qualify for recognition as assets, they shall be recognised as expenses.**

6 Typically, an expense arises from the consumption of goods or services. For example, services are typically consumed immediately, in which case an expense is recognised as the counterparty renders services. Goods might be consumed over a period of time or, in the case of inventories, sold at a later date, in which case an expense is recognised when the goods are consumed or sold. However, sometimes it is necessary to recognise an expense before the goods or services are consumed or sold, because they do not qualify for recognition as assets. For example, an entity might acquire goods as part of the research phase of a project to develop a new product. Although those goods have not been consumed, they might not qualify for recognition as assets under the applicable IFRS.

EQUITY-SETTLED SHARE-BASED PAYMENT TRANSACTIONS

Overview

7 **For equity-settled share-based payment transactions, the entity shall measure the goods or services received, and the corresponding increase in equity, either directly, at the *fair value* of the goods or services received, or indirectly, by reference to* the fair value of the *equity instruments granted*, whichever fair value is more readily determinable.**

8 If the fair value of the goods or services received is measured directly, fair value shall be measured at the date the entity obtains those goods or the counterparty renders service. If the fair value of the goods or services received is measured indirectly, by reference to the fair value of the equity instruments granted, fair value shall be measured at *grant date*. The fair value of the equity instruments granted measured at grant date is a surrogate measure of the fair value of the goods or services received.

9 For transactions with parties other than employees, there shall be a rebuttable presumption that the fair value of the goods or services received is the more readily determinable fair value.

10 Typically, an established market price exists for goods and, in many cases, for services rendered by parties other than employees. Therefore, it shall be presumed that the fair value of the goods or services received is more readily determinable than the fair value of the equity instruments granted. This presumption might be rebutted, for example, if shares are granted to a supplier of services, in addition to a cash payment at market rates, as a bonus for achieving a particular performance target. In this situation, the fair value of the shares granted might be more readily determinable than the fair value of the services received.

11 For transactions with employees, the entity shall measure the fair value of the employee services received by reference to the fair value of the equity instruments granted, because the latter fair value is more readily determinable than the fair value of the employee services received.

12 Typically, shares, options or other equity instruments are granted to employees as part of their pay package, in addition to a cash salary and other employment benefits. Usually, it is not possible to measure directly the services received for particular components of the employee's pay package. It might also not be possible to measure the fair value of the total pay package independently, without measuring directly the fair value of the equity instruments granted. Furthermore, options or shares are sometimes granted as part of a bonus arrangement, rather than as a part of basic pay, eg as an incentive to the employees to remain in the entity's

* This [draft] IFRS uses the phrase 'by reference to' rather than 'at', because the fair value of the equity instruments granted is used to derive the deemed fair value of each unit of service received, as explained in paragraph 15.

employ or to reward them for their efforts in improving the entity's performance. By granting options, in addition to other remuneration, the entity is paying additional remuneration to obtain additional benefits. Estimating the fair value of those additional benefits is likely to be difficult. Therefore, the entity shall measure the fair value of the employee services received by reference to the fair value of the equity instruments granted, because the latter fair value is more readily determinable than the fair value of the employee services received.

13 If the equity instruments granted *vest* immediately, the counterparty is not required to complete a specified period of service before becoming unconditionally entitled to those equity instruments. In the absence of evidence to the contrary, the entity shall presume that services rendered by the counterparty as consideration for the equity instruments have been received. In this case, on grant date the entity shall recognise the services received in full, with a corresponding increase in equity.

14 If the equity instruments granted do not vest until the counterparty completes a specified period of service, the entity shall presume that the services to be rendered by the counterparty as consideration for those equity instruments will be received in the future, during the *vesting period*. The entity shall account for those services when they are rendered by the counterparty during the vesting period, with a corresponding increase in equity.

15 If the services received are measured by reference to the fair value of the equity instruments granted, the entity shall determine the amount to attribute to each *unit of service* received. To determine this amount, the entity shall:

(a) presume that at grant date the total fair value of the equity instruments granted to the counterparty (or counterparties), determined in accordance with paragraphs 17–25, equals the total fair value of the services the entity expects to receive during the vesting period from that counterparty (or counterparties).

(b) estimate at grant date the number of units of service it expects to receive during the vesting period from the counterparty (or counterparties). To make this estimate, the entity shall estimate the extent to which the counterparty (or counterparties) is (are) expected to complete the specified period of service.

(c) divide the fair value of the equity instruments granted by the number of units of service expected to be received during the vesting period.

This amount is the deemed fair value of each unit of service subsequently received.

The entity shall measure the services received in each period by multiplying the number of units of service received from the counterparty (or counterparties) during that period by the deemed fair value per unit of service. If a counterparty ceases to render service during the period (eg an employee leaves), the entity shall include the services received from that counterparty before cessation of service in determining the number of units of service received during the period, but shall not recognise any further amounts in respect of that counterparty. This accounting method is illustrated in Appendix B.

16 Having recognised the services received and a corresponding increase in equity, the entity shall make no subsequent adjustment to total equity, even if the equity instruments granted are later forfeited or, in the case of options, the options are not exercised. However, this requirement does not preclude the entity from recognising a transfer within equity, ie a transfer from one component of equity to another.

Fair value of equity instruments granted

17 An entity shall measure the fair value of equity instruments granted, based on market prices if available, taking into account the terms and conditions upon which those equity instruments were granted.

18 The discussion below focuses on grants of shares or options, and specific terms and conditions that are common features of such grants to employees. Therefore, it is not exhaustive.

19 The fair value of shares granted shall be measured at the market price of the entity's shares (or an estimated market price, if the entity's shares are not publicly traded), adjusted to take into account the terms and conditions upon which those shares were granted (for example, adjusted for expected dividends and vesting conditions, in accordance with paragraphs 23 and 24).

20 The fair value of options granted shall be measured at the market price of traded options with similar terms and conditions. However, in many cases such traded options do not exist, because the options granted are subject to terms and conditions that do not apply to traded options. For example, employee share options are typically non-transferable and subject to *vesting conditions*. If traded options with similar terms and

conditions do not exist, the fair value of the options granted shall be estimated by applying an option pricing model, such as the Black-Scholes model or a binomial model. The model applied shall take into account all of the following factors:

(a) the exercise price of the option;

(b) the life of the option (in accordance with paragraph 21);

(c) the current price of the underlying shares;

(d) the expected *volatility* of the share price;

(e) the dividends expected on the shares (if appropriate, in accordance with paragraph 23); and

(f) the *risk-free interest rate* for the life of the option.

21 For non-transferable options, the option's *expected life* rather than its contracted life shall be used in applying an option pricing model. For transferable options, the option's contracted life shall be used.

22 For options that are subject to vesting conditions and cannot therefore be exercised during the vesting period:

(a) if an entity uses an option pricing model that values options that can be exercised at any time during the option's life, such as a binomial model, the application of the model shall take account of the inability to exercise the options during the vesting period.

(b) if an entity uses an option pricing model that values options that can be exercised only at the end of the option's life, such as the Black-Scholes model, no adjustment is required for the inability to exercise them during the vesting period because the model assumes that the options cannot be exercised during that period.

23 When an entity measures the fair value of options or shares granted, expected dividends on the shares shall be taken into account (eg by being included as an input to an option pricing model) if the counterparty is not entitled to receive dividends or dividend equivalents for a specified period, such as during the vesting period or until the options are exercised.

24 If a grant of shares or options is conditional upon satisfying specified vesting conditions, those conditions shall be taken into account when an entity measures the fair value of the shares or options granted. For example, a grant of shares or options to an employee is typically

conditional on the employee's remaining in the entity's employ for a specified period of time. There might also be performance conditions that must be satisfied, such as the entity's achieving a specified growth in profit or a specified increase in the entity's share price. Vesting conditions shall be taken into account either by incorporating them into the application of an option pricing model or by making an appropriate adjustment to the value produced by such a model.

25 For options with a *reload feature*, the reload feature shall be taken into account, where practicable, when an entity measures the fair value of the options granted. However, if the reload feature is not taken into account in the measurement of the fair value of the options granted, then the *reload option* granted shall be accounted for as a new option grant.

Modifications to the terms and conditions on which equity instruments were granted

26 An entity might modify the terms and conditions on which the equity instruments were granted. For example, it might reduce the exercise price of options granted to employees (ie reprice the options), which increases the fair value of those options.

27 Measuring the services received as consideration for the options granted by reference to the fair value of the options granted presumes that the fair value of the options granted is a reasonable surrogate measure of the fair value of the services received. Therefore, any changes to the terms and conditions on which the options were granted must be taken into account when measuring the services received. Hence, the measurement of the services received shall include the incremental value granted on repricing (ie the difference between the fair value of the repriced option and that of the original option, both estimated as at the date of repricing), as explained in paragraph 28.

28 To apply the requirement in paragraph 27, the entity shall determine the amount to attribute to each unit of service received in respect of the incremental value granted, by dividing the incremental value granted by the number of units of service it expects to receive during the period from the date of repricing until the end of the vesting period of the repriced options, as estimated at the date of repricing. This amount is deemed to be the fair value of each unit of service received in respect of the incremental value granted. The entity shall account for the services received in each period by multiplying the number of units of service rendered by the employees during that period by their deemed fair value

per unit. The entity shall continue to account for the services received in respect of the original option grant. This accounting method is illustrated in Appendix B.

29 If the entity cancels a grant of shares or options during the vesting period (other than a grant cancelled by forfeiture when the vesting conditions are not satisfied):

(a) the entity shall continue to account for services rendered by the counterparty during the remainder of the vesting period, as if that grant had not been cancelled.

(b) any payment made to the counterparty on the cancellation of the grant shall be accounted for as the repurchase of an equity interest, ie as a deduction from equity, except to the extent that the payment exceeds the fair value of the shares or options granted, measured at the repurchase date. Any such excess shall be recognised as an expense.

(c) if new options are granted to the counterparty and, on the date when those new options are granted, the entity identifies the new options granted as replacement options for the cancelled options, the entity shall account for the granting of replacement options in the same way as a repricing of options, in accordance with paragraph 28. The incremental value granted is the difference between the fair value of the replacement options and the net fair value of the cancelled options, at the date the replacement options are granted. The net fair value of the cancelled options is their fair value less the amount of any payment made to the counterparty on cancellation of the options that is accounted for as a deduction from equity in accordance with (b) above. If the entity does not identify new options granted as replacement options for the cancelled options, the entity shall account for those new options as a new option grant. An example is given in Appendix B.

30 If an entity repurchases vested equity instruments, the payment made to the counterparty shall be accounted for as a deduction from equity, except to the extent that the payment exceeds the fair value of the equity instruments repurchased at the repurchase date. Any such excess shall be recognised as an expense.

CASH-SETTLED SHARE-BASED PAYMENT TRANSACTIONS

31 For cash-settled share-based payment transactions, the entity shall measure the goods or services acquired and the liability incurred at the fair value of the liability. Until the liability is settled, the entity shall remeasure the fair value of the liability at each reporting date, with any changes in fair value recognised in profit or loss.

32 For example, an entity might grant share appreciation rights to employees as part of their pay package, whereby the employees will become entitled to a future cash payment (rather than an equity instrument), based on the increase in the entity's share price from a specified level over a specified period of time.

33 The entity shall recognise the services received, and a liability to pay for those services, as the employees render service. For example, some share appreciation rights vest immediately, and the employees are therefore not required to complete a specified period of service to become entitled to the cash payment. In the absence of evidence to the contrary, the entity shall presume that the services rendered by the employees in exchange for the share appreciation rights have been received. Thus, the entity shall recognise immediately the services received and a liability to pay for them. If the share appreciation rights do not vest until the employees have completed a specified period of service, the entity shall recognise the services received, and a liability to pay for them, as the employees render service during that period.

34 The liability shall be measured, initially and at each reporting date until settled, at the fair value of the share appreciation rights, by applying an option pricing model, taking into account the terms and conditions on which the share appreciation rights were granted, and the extent to which the employees have rendered service to date. For example, if the share appreciation rights granted are conditional upon the employees' remaining in the entity's employ for the next three years and the employees have completed only one year's service at the reporting date, the entity shall measure the fair value of the liability at the reporting date by applying an option pricing model—adjusted as appropriate to allow for the possibility of forfeiture of the share appreciation rights—and multiplying the resulting amount by one-third. The entity shall remeasure the fair value of the liability at each reporting date until settled. An illustrative example is given in Appendix C.

SHARE-BASED PAYMENT TRANSACTIONS WITH CASH ALTERNATIVES

35 **For share-based payment transactions in which either the entity or the counterparty may choose whether the entity settles the transaction in cash or by issuing equity instruments, the entity shall account for that transaction, or the components of that transaction, as a cash-settled share-based payment transaction if the entity has incurred a liability to settle in cash or other assets, or as an equity-settled share-based payment transaction if no such liability has been incurred.**

Share-based payment transactions in which the counterparty has the choice of settlement

36 If an entity has granted the counterparty the right to choose whether a share-based payment transaction is settled in cash or by issuing equity instruments, the entity has granted a compound financial instrument, which includes a debt component (the counterparty's right to demand payment in cash) and an equity component (the counterparty's right to demand settlement in equity instruments rather than in cash). For transactions with parties other than employees in which the fair value of the goods or services received is measured directly, the entity shall measure the equity component of the compound financial instrument as the difference between the fair value of the goods or services received and the fair value of the debt component, at the date when the goods or services are received.

37 For other transactions, including transactions with employees, the entity shall measure the fair value of the compound financial instrument at grant date, taking into account the terms and conditions on which the rights to cash or equity instruments were granted.

38 To apply paragraph 37, the entity shall first measure the fair value of the debt component, and then measure the fair value of the equity component—taking into account that the counterparty must forfeit the right to receive cash to receive the equity instrument. The fair value of the compound financial instrument is the sum of the fair values of the two components. However, share-based payment transactions in which the counterparty has the choice of settlement are often structured so that the fair value of one settlement alternative is the same as the other. For example, the counterparty might have the choice of receiving share options or cash-settled share appreciation rights. In such cases, the fair value of the equity component is zero, and hence the fair value of the compound financial instrument is the same as the fair value of the debt component. Conversely, if the fair values of the settlement alternatives differ, the fair value of the equity component is greater than zero, and hence the fair value of the compound financial instrument is greater than the fair value of the debt component.

39 The entity shall account separately for the goods or services received or acquired in respect of each component of the compound financial instrument. For the debt component, the entity shall recognise the goods or services acquired, and a liability to pay for those goods or services, as the counterparty supplies goods or renders service, in the same way as other cash-settled share-based payment transactions (paragraphs 31–34). For the equity component (if any), the entity shall recognise the goods or services received, and an increase in equity, as the counterparty supplies goods or renders service, in the same way as other equity-settled share-based payment transactions (paragraphs 7-30).

40 At the date of settlement, the entity shall remeasure the liability to its fair value. If the entity issues equity instruments on settlement rather than paying cash, the liability shall be transferred direct to equity, as the consideration for the equity instruments issued.

41 If the entity pays cash on settlement rather than issuing equity instruments, that cash payment shall be applied to settle the liability in full. Any equity component previously recognised shall remain within equity. By electing to receive cash on settlement, the counterparty forfeited the right to receive equity instruments. However, this requirement does not preclude the entity from recognising a transfer within equity, ie a transfer from one component of equity to another.

Share-based payment transactions in which the entity has the choice of settlement

42 For a share-based payment transaction in which an entity may choose whether to settle in cash or by issuing equity instruments, the entity shall determine whether it has a present obligation to settle in cash and account for the share-based payment transaction accordingly. The entity has a present obligation to settle in cash if the choice of settlement in equity instruments is not substantive, or if the entity has a past practice or a stated policy of settling in cash.

43 If such an obligation exists, the entity shall account for the transaction in accordance with the requirements applying to cash-settled share-based payment transactions, in paragraphs 31–34.

44 If no such obligation exists, the entity shall account for the transaction in accordance with the requirements applying to equity-settled transactions, in paragraphs 7–30. Upon settlement:

(a) if the entity elects to settle in cash, the cash payment shall be accounted for as the repurchase of an equity interest, ie as a deduction from equity, except as noted in (c) below.

(b) if the entity elects to settle by issuing equity instruments, no further accounting is required (other than a transfer from one component of equity to another, if necessary), except as noted in (c) below.

(c) if the entity elects the settlement alternative with the higher fair value, as at the date of settlement, the entity shall recognise an additional expense for the excess value given, ie the difference between the cash paid (the fair value of the equity instruments issued) and the fair value of the equity instruments that would otherwise have been issued (the amount of cash that would otherwise have been paid).

DISCLOSURES

45 An entity shall disclose information that enables users of the financial statements to understand the nature and extent of *share-based payment arrangements* that existed during the period.

46 To give effect to the principle in paragraph 45, the entity shall disclose at least the following:

(a) a description of each type of share-based payment arrangement that existed at any time during the period, including details of:

(i) whether the rights granted by the entity to employees or other parties pursuant to the arrangement consisted of rights to shares, share options, other equity instruments, cash or other assets;

(ii) when those rights were granted;

(iii) those to whom the rights were granted (eg a description of the number and class of employees participating in a group employee share plan);

(iv) the contractual life of options granted;

(v) whether the exercise price is fixed or variable (and, if variable, how the exercise price is determined); and

(vi) a description of the vesting requirements, including service conditions and performance conditions.

(b) the number and weighted average exercise prices of options for each of the following groups of options:

(i) outstanding at the beginning of the period;

(ii) granted during the period;

(iii) forfeited during the period;

(iv) exercised during the period;

(v) expired during the period;

(vi) outstanding at the end of the period; and

(vii) exercisable at the end of the period.

(c) for options exercised during the period, the weighted average share price at the date of exercise.

(d) for options outstanding at the end of the period, the range of exercise prices and weighted average remaining expected life and contractual life. If the range of exercise prices is wide, the outstanding options shall be divided into ranges that are meaningful for assessing the number and timing of additional shares that may be issued and the cash that may be received upon exercise of those options.

47 An entity shall disclose information to enable users of the financial statements to understand how the fair value of the goods or services received, or the fair value of the equity instruments granted, during the period was determined.

48 If the entity has measured the fair value of goods or services received as consideration for equity instruments of the entity indirectly, by reference to the fair value of the equity instruments granted, to give effect to the principle in paragraph 47, the entity shall disclose at least the following:

(a) for options granted during the period, the weighted average fair value of those options at grant date and information on how that fair value was measured, including:

(i) the option pricing model used and the inputs to that model, including share price, exercise price, expected volatility, option life (including whether expected or contracted life was used), expected dividends, the risk-free interest rate and any other inputs to the model;

(ii) historical volatility and an explanation of the differences between historical and expected volatility, or an explanation of how expected volatility was determined if it was not based on historical volatility;

(iii) an explanation of how the risk-free interest rate was determined;

(iv) the assumptions made with regard to vesting conditions and an explanation of how vesting conditions have been taken into account in measuring fair value, including the resulting impact on the fair value measure; and

(v) whether and how a reload feature and any other features of the option grant were incorporated into the measurement of fair value.

(b) for shares or other equity instruments granted during the period, the number and weighted average fair value of those shares or other equity instruments at grant date, and information on how that fair value was measured, including:

(i) if fair value was not measured on the basis of an observable market price, how it was determined;

(ii) the assumptions made with regard to vesting conditions and an explanation of how vesting conditions have been taken into account in measuring fair value, including the resulting impact on the grant date valuation;

(iii) whether and how expected dividends were incorporated into the measurement of fair value; and

(iv) whether and how any other features of the shares or other equity instruments granted were incorporated into the measurement of fair value.

(c) for rights to cash, or rights to either cash or equity instruments, granted during the period pursuant to a cash-settled share-based payment arrangement or a share-based payment arrangement with a cash alternative, the weighted average fair value of those rights at grant date, split into their debt and equity components, and information on how these fair values were measured, consistently

with the requirements set out in (a) and (b) above, where applicable.

(d) for share-based payment arrangements that were modified during the period:

(i) an explanation of those modifications;

(ii) the incremental fair value granted (as a result of those modifications); and

(iii) information on how the incremental fair value granted was measured, consistently with the requirements set out in (a)–(c) above, where applicable.

(e) for options, shares, or other equity instruments that vested during the period, or would have vested during the period had the vesting conditions been satisfied (ie equity instruments that would have vested during the period if the counterparty had completed the specified service period and/or if the specified performance conditions had been satisfied), a comparison of the percentage or number of equity instruments that vested and the grant date estimate of the percentage or number expected to vest.

(f) for options that were exercised during the period, a comparison of actual option life and the grant date estimate of expected life.

49 If an entity has measured directly the fair value of goods or services received during the period, the entity shall disclose how that fair value was determined, eg whether fair value was measured at an established market price for those goods or services.

50 If an entity has rebutted the presumption in paragraph 9, it shall disclose that fact, and give an explanation of why the presumption was rebutted.

51 An entity shall disclose information that enables users of the financial statements to understand the effect of expenses arising from share-based payment transactions on the entity's profit or loss for the period.

52 To give effect to the principle in paragraph 51, the entity shall disclose at least the following:

(a) the total expense recognised for the period arising from share-based payment transactions, including that portion of the total expense that arises from transactions accounted for as equity-settled share-based payment transactions; and

(b) for cash-settled share-based payment transactions, the portion of the expense recognised for the period that is attributable to the transaction having been measured as a cash-settled transaction rather than as an equity-settled transaction.

53 If the information required to be disclosed by this [draft] IFRS does not satisfy the principles in paragraphs 45, 47 and 51, the entity shall disclose such additional information as is necessary to satisfy them.

TRANSITIONAL PROVISIONS

54 For equity-settled share-based payment transactions, the entity shall apply the requirements of this [draft] IFRS to grants of shares, options or other equity instruments that were granted after [date to be inserted, being the publication date of this Exposure Draft] that had not yet vested at the effective date of this [draft] IFRS.

55 For liabilities arising from share-based payment transactions existing at the effective date of this [draft] IFRS, the entity shall apply retrospectively the requirements of this [draft] IFRS, except that the entity is not required to measure vested share appreciation rights (and similar liabilities in which the counterparty holds vested rights to cash or other assets of the entity) at fair value. Such liabilities shall be measured at their settlement amount (ie the amount that would have been paid on settlement of the liability had the counterparty demanded settlement at the date the liability is measured).

EFFECTIVE DATE

56 An entity shall apply this [draft] IFRS in its annual financial statements for periods beginning on or after 1 January 2004 [provided that the IFRS is issued before the end of 2003]. Earlier adoption is encouraged. If an entity applies the [draft] IFRS in its financial statements for a period beginning before 1 January 2004, it shall disclose that fact.

Appendix A
Defined terms

This appendix is an integral part of the [draft] IFRS. It lists the terms that are used in this [draft] IFRS with a specific meaning, as defined in the Glossary.

cash-settled share-based payment transaction

equity instrument

equity instruments granted

equity-settled share-based payment transaction

expected life

fair value

grant date

reload feature

reload option

risk-free interest rate

share-based payment arrangement

share-based payment transaction

share option

unit of service

vest

vesting conditions

vesting period

volatility

Appendix B
Equity-settled share-based payment transactions

This appendix is an integral part of the [draft] IFRS

B1 Paragraph 15 of this [draft] IFRS sets out requirements for an equity-settled share-based payment transaction in which the fair value of the services received is measured by reference to the fair value of the equity instruments granted. It requires the entity to determine the fair value of each unit of service received by dividing the fair value of the equity instruments granted by the number of units of service expected to be received during the vesting period, as estimated at grant date.

B2 There is an underlying presumption that the fair value of the equity instruments granted provides a reasonable surrogate measure of the fair value of the services received. In other words, it is presumed that a fair bargain is made at grant date, and hence the fair value of the equity instruments granted is the same as the fair value of the services expected to be received in return for those equity instruments. Dividing the fair value of the equity instruments granted by the number of units of services expected to be received produces a deemed fair value per unit of service, which is then applied to the units of services actually received. This accounting method is illustrated and explained further in Example 1.

B3 In the examples in this appendix, the options granted all vest at the same time, at the end of a specified period. In some situations, options or other equity instruments granted might vest in instalments over the vesting period. For example, suppose an employee is granted 100 options, which will vest in instalments of 25 options each at the end of each year over the next four years. To apply the requirements of this [draft] IFRS, the entity shall treat each instalment as a separate option grant, as each instalment has a different vesting period, and hence the fair value of each instalment will differ (because the possibility of forfeiture and the options' expected life will differ), as will the number of units expected to be received for each instalment.

Example 1

BACKGROUND

An entity grants 100 options to each of its 500 employees. Each grant is conditional upon the employee working for the entity over the next three

years. The entity estimates that the fair value of each option is CU15,* before adjusting for the possibility of forfeiture due to failure of the employee to complete the required three-year period of service. On the basis of a weighted average probability, the entity estimates that 20 per cent of employees will leave during the three-year period and therefore forfeit their rights to the options. Therefore, the total fair value of the options granted = 500 employees × 100 options × CU15 × 80% = CU600,000. (It should be noted that the use of a weighted average probability to adjust the fair value of each option for the possibility of forfeiture is not the only method that could be used. Paragraph 24 of the [draft] IFRS does not specify a particular method to apply when taking vesting conditions into account in the estimate of the fair value of the shares or options granted.)

The entity also estimates, on the basis of a weighted average probability, that the employee departures will be spread evenly over the three years.

Therefore, the entity expects to receive three years' service from 400 employees (500 × 80%), and it also expects to receive services from the other 20 per cent of employees before they leave. Because their departures are expected to occur evenly over the three years, the entity expects to receive, on average, 1.5 years of service from each of the 100 employees who are expected to leave before vesting date. Therefore, the entity expects to receive in total (3 years' service × 400 employees) + (1.5 years' service × 100 employees) = 1,350 'years' (units) of service from the employees.

To determine the fair value of each unit of service expected to be received, the fair value of the options granted (CU600,000) is divided by the number of units of service expected to be received during the vesting period (1,350), which gives a deemed fair value of CU444.44 per unit of employee service.

This value (CU444.44 per unit of employee service) is based on the presumption that the agreement between the entity and its employees at grant date is fairly bargained: the entity granted options valued at CU600,000 at grant date, and it is presumed that the entity expects to receive services valued at CU600,000 in return. Given that the entity expects to receive 1,350 units of service from the employees, this gives a deemed fair value of each unit of service of CU444.44.

* In this example, and in all other examples in the appendices, monetary amounts are denominated in 'currency units' (CU).

If everything turns out as expected (Scenario 1 below), the entity will recognise a total of CU600,000 for services received and consumed. If the entity receives more services than originally expected (Scenario 2 below), it will recognise more than CU600,000. If the entity receives fewer services than expected (Scenario 3 below), it will recognise less than CU600,000.

This accounting method is designed to achieve the accounting objective, which is to account for the services received during the vesting period. The fair value of the options granted is used as a surrogate measure, to determine the fair value of the services received during the vesting period.

APPLICATION OF REQUIREMENTS

Scenario 1

If everything turns out exactly as expected, the entity recognises the following amounts during the vesting period, for services received as consideration for the options.

	CU
Year 1	
(467 + (33 × 0.5)) units of service × CU444.44 =	214,889
Year 2	
(433 + (34 × 0.5)) units of service × CU444.44 =	200,000
Year 3	
(400 + (33 × 0.5)) units of service × CU444.44 =	185,111
Total over three years	600,000

Scenario 2

If fewer employees leave than originally estimated, or those that leave stay longer before leaving, the total amount will be higher than in Scenario 1, because more services would be received than expected. For example, suppose that only 50 employees leave, and they all leave at the end of year 2:

	CU
Year 1	
500 units of service × CU444.44 =	222,222
Year 2	
500 units of service × CU444.44 =	222,222
Year 3	
450 units of service × CU444.44 =	200,000
Total over three years	644,444

Scenario 3

If more employees leave than originally estimated, or they leave earlier than expected, the total amounts recognised will be lower than in Scenario 1, because fewer services would be received than expected. Suppose 75 employees leave halfway through year 1, another 75 leave three months from the start of year 2 and 40 leave halfway through year 3, so there are 310 employees at the end of year 3.

	CU
Year 1	
(425 + (75 × 0.5)) units of service × CU444.44 =	205,554
Year 2	
(350 + (75 × 0.25)) units of service × CU444.44 =	163,887
Year 3	
(310 + (40 × 0.5)) units of service × CU444.44 =	146,667
Total over three years	516,108

B4 In Example 1, the options were granted conditionally upon the employees' completing a specified service period. In some cases, an option or share grant might also be conditional upon the achievement of a specified performance target. Example 2 illustrates the application of the accounting method specified in paragraph 15 of the [draft] IFRS to option or share grants with performance conditions.

Example 2

The initial facts are the same as in Example 1, except that the option grant is also conditional upon the entity achieving an 18 per cent increase in its share price by the end of the three-year service period. On the basis of a weighted average probability, the entity estimates that the possibility of forfeiture due to failure to achieve the performance target is

15 per cent. (As noted in Example 1, the use of a weighted average probability to adjust the fair value of each option for the possibility of forfeiture is not the only method that could be used. Paragraph 24 of the [draft] IFRS does not specify a particular method to apply when taking vesting conditions into account in the estimate of the fair value of the shares or options granted.)

Therefore, the entity estimates that the total fair value of the options granted = 500 employees × 100 options × CU15 × 80%* × 85%† = CU510,000.

*The weighted average probability that the employees will complete the required service period.

†The weighted average probability that the specified performance target will be achieved.

As in Example 1, the entity expects to receive 1,350 units of service during the three-year vesting period, and hence the deemed fair value per unit of employee service = CU510,000/1,350 = CU377.77.

Suppose the entity receives 430 units of service in year 1, 400 units of service in year 2 and 375 units of service in year 3, ie a total of 1,205 units of service. The amounts recognised in each year are as follows:

	CU
Year 1	
430 units of service × CU377.77 =	162,441
Year 2	
400 units of service × CU377.77 =	151,108
Year 3	
375 units of service × CU377.77 =	141,664
Total	455,213

The amounts recognised each year are not subsequently adjusted, even if the performance target is not achieved.

B5 Paragraphs 27 and 28 of the [draft] IFRS set out requirements that apply if an option is repriced (or the entity otherwise modifies the terms or conditions of a share-based payment arrangement). It requires the incremental value granted on repricing to be taken into account when measuring the services received. This entails determining the amount to attribute to each unit of service received in respect of the incremental value granted, by dividing the incremental value granted by the number of units of services expected to be received during the period from the date

of repricing until the end of the vesting period of the repriced options, as estimated at the date of repricing. The entity then accounts for the services received in each accounting period by multiplying the number of units of service received during that period by their deemed fair value per unit. The entity also continues to account for the services received in respect of the original option grant. Example 3 illustrates these requirements.

Example 3

BACKGROUND

The initial facts at grant date are the same as for Example 1.

Suppose that 40 employees leave during year 1, a further 50 employees leave during year 2, and on average all those employees complete six months' service in the year of their departure. Also suppose that by the end of year 2, the entity's share price has dropped, and the entity reprices its options, and that the repriced options vest at the end of year 4. The entity expects a further 10 employees to leave during each of years 3 and 4, with the departing employees completing on average six months' service in the year of their departure.

The entity estimates that, at the date of repricing, the fair value of each of the original options granted (ie before taking into account the repricing) is CU5 and that the fair value of each repriced option is CU8.

APPLICATION OF REQUIREMENTS

The incremental value is calculated as follows:

(CU8 - CU5) × 410 employees × 100 options per employee = CU123,000

The entity expects to receive (390 × 2) + (10 × 0.5) + (10 × 1.5) = 800 units of service during years 3 and 4. Therefore, the amount to attribute to each unit of service received in respect of the incremental value granted is CU123,000/800 = CU153.75 per year (unit) of employee service.

Suppose everything turns out as expected. The amounts recognised in years 1–4 are as follows:

		CU
Year 1		
Original grant		
(460 + (40 × 0.5)) units of service × CU444.44 =		213,331
Year 2		
Original grant		
(410 + (50 × 0.5)) units of service × CU444.44 =		193,331
Year 3		
Original grant		
(400 + (10 × 0.5)) units of service × CU444.44 =	CU179,998	
Incremental value granted		
(400 + (10 × 0.5)) units of service × CU153.75 =	CU 62,268	
Total		242,266
Year 4		
Incremental value granted		
(390 + (10 × 0.5)) units of service × CU153.75 =		60,732
Total		709,660

The total is made up of 1,320 units of service at CU444.44 per year = CU586,660 in respect of the original option grant, plus 800 units of service at CU153.75 per year = CU123,000 in respect of the new option grant on repricing.

There is a larger expense in year 3, because that year includes the final year of the original option grant and the first year of the incremental value granted on repricing. This is consistent with the requirements of paragraph 30 of the [draft] IFRS, which treats the incremental value granted on repricing as a new option grant, in addition to the original option grant.

[An alternative approach would be to average the two grants and recognise an averaged amount over years 3 and 4, as shown below.

Original grant = CU444.44 per year of service, with one year to vest at date of repricing, during which the entity expects to receive 405 units of service.

New grant = CU153.75 per year of service, with two years to vest, during which the entity expects to receive 800 units of service.

Average over two-year vesting period of new grant:

((CU444.44 × 405) + (CU153.75 × 800))/800 = CU378.75 per employee per year of service.

If everything turns out as expected:

	CU
Year 1	
(460 + (40 × 0.5)) units of service × CU444.44 =	213,331
Year 2	
(410 + (50 × 0.5)) units of service × CU444.44 =	193,331
Year 3	
(400 + (10 × 0.5)) units of service × CU378.75 =	153,393
Year 4	
(390 + (10 × 0.5)) units of service × CU378.75 =	149,605
Total	709,660

Respondents are asked for comments on this alternative approach in Question 17 of the Invitation to Comment.]

B6 Paragraph 29 of the [draft] IFRS sets out requirements that apply if a share or option grant is cancelled during the vesting period. If new options are granted to the counterparty and, on the date of that grant, the entity identifies the new options granted as replacement options for the cancelled options, the entity accounts for the replacement options as a repricing of options, in accordance with paragraph 28 of the [draft] IFRS. The incremental value granted is the difference between the fair value of the replacement options and the net fair value of the cancelled options (measured as if they had not been cancelled), at the date the replacement options are granted. The net fair value of the cancelled options is their fair value less the amount of any payment made to the counterparty on cancellation of the options that is accounted for as a deduction from equity in accordance with paragraph 29(b) of the [draft] IFRS. Example 4 illustrates these requirements.

Example 4

BACKGROUND

The initial facts at grant date are the same as in Example 1. As in Example 3, 40 employees leave during year 1, a further 50 employees leave during year 2, and on average all those employees complete six months' service in the year of their departure. At the end of year 2, the entity's share price has fallen. The entity cancels the original option grant and grants each of the remaining 410 employees 100 options each, conditional upon the employees' remaining in the entity's employ for two years. The entity estimates that the fair value of the new options granted is CU8 each (after allowing for the possibility of forfeiture), and it identifies the new options as replacement options for the cancelled options. The entity estimates that the fair value of the cancelled options is CU5 each (measured as if the options had not been cancelled, and after allowing for the possibility of forfeiture) at the date the replacement options were granted.

APPLICATION OF THE REQUIREMENTS

Given that the entity identifies the new option grant as replacement options for the cancelled options, it accounts for the new option grant as a repricing. Therefore, the entity calculates the incremental value granted as follows:

(CU8 fair value of new options - CU5 fair value of cancelled options) × 410 employees × 100 options per employee = CU123,000.

The entity expects to receive (390 × 2) + (10 × 0.5) + (10 × 1.5) = 800 units of service during years 3 and 4. Therefore, the amount to attribute to each unit of service rendered in respect of the incremental value granted of CU123,000 = CU153.75 per employee per year of service.

As required by paragraph 29(a) of the [draft] IFRS, the entity continues to account for the services received in respect of the original option grant as if that option grant had not been cancelled. The entity also accounts for the services received in respect of the incremental value granted on replacement of those options.

If everything turns out as expected, the amounts recognised in years 1–4 are the same as in Example 4 above.

If the entity does not identify the new option grant as replacement options for the cancelled options, it continues to account for the services received in respect of the original option grant, and it also accounts for the services received in respect of the new option grant. The fair value of the new options granted = CU8 × 410 × 100 = CU328,000. The amount to attribute to each unit of service received in respect of the new option grant = CU328,000/800 = CU410 per unit of service. The amounts recognised in years 1-4 are as follows:

		CU
Year 1		
Original grant		
(460 + (40 × 0.5)) units of service × CU444.44 =		213,331
Year 2		
Original grant		
(410 + (50 × 0.5)) units of service × CU444.44 =		193,331
Year 3		
Original grant		
(400 + (10 × 0.5)) units of service × CU444.44 =	CU179,998	
New option grant		
(400 + (10 × 0.5)) units of service × CU410 =	CU166,050	
Total		346,048
Year 4		
New option grant		
(390 + (10 × 0.5)) units of service × CU410 =		161,950
Total		914,660

Appendix C
Cash-settled share-based payment transactions

This appendix is an integral part of the [draft] IFRS.

C1 Paragraphs 31–34 of the [draft] IFRS set out requirements for transactions in which an entity acquires goods or services by incurring liabilities to the supplier of those goods or services in amounts based on the price of the entity's shares or other equity instruments.

C2 The entity is required to recognise initially the goods or services acquired, and a liability to pay for those goods or services, when the entity obtains the goods or as the services are rendered, measured at the fair value of the liability. Thereafter, until the liability is settled, the entity is required to recognise changes in the fair value of the liability. Paragraph 52(b) requires the entity to disclose the portion of the expense recognised for the period that is attributable to the transaction having been measured as a cash-settled transaction rather than as an equity-settled transaction. This requirement is intended to assist users of financial statements in understanding the income statement effect arising from the remeasurement of the liability between grant date and settlement date. The example below illustrates these requirements.

Example

BACKGROUND

An entity grants 100 cash share appreciation rights (SARs) to each of its 500 employees, on condition that the employees remain in its employ for the next three years.

The entity estimates that at grant date the fair value of each SAR granted is CU12, by applying an option pricing model and adjusting the value produced by that model to take into account the possibility of forfeiture due to failure of the employee to complete the required three-year period of service. Therefore, the total fair value of the SARs granted = 500 employees × 100 options × CU12 = CU600,000.

On the basis of a weighted average probability, the entity estimates that 20 per cent of the employees will leave during the three-year period.

The entity also estimates that the employee departures will be spread evenly over the three years.

Therefore, the entity expects to receive three years' service from 400 employees (500 × 80%), and it expects to receive services from the other 20 per cent of employees before they leave. Because their departures are expected to occur evenly over the three years, the entity expects to receive, on average, 1.5 years' service from each of the 100 employees who are expected to leave before vesting date. Therefore, the entity expects to receive in total (3 years' service × 400 employees) + (1.5 years' service × 100 employees) = 1,350 'years' (units) of service from the employees.

Hence, for an equivalent equity-settled transaction, the deemed fair value of each unit of service rendered during the vesting period would be CU600,000/1,350 = CU444.44. (This information is needed to determine the amount to disclose under paragraph 52(b) of the [draft] IFRS.)

Fifty employees leave during year 1, 40 employees leave during year 2, and 20 employees leave during year 3, and in each year the employees complete an average of six months' service before their departure. At the end of year 3, 150 employees exercise their SARs, another 140 employees exercise their SARs at the end of year 4 and the remaining 100 employees exercise their SARs at the end of year 5.

The entity estimates the fair value of the SARs at the end of each year in which a liability exists as shown below. Note that in years 1 and 2, the fair value estimate takes into account the possibility of forfeiture. At the end of year 3, all SARs held by the remaining employees vest. The intrinsic values of the SARs at the date of exercise (which equal the cash paid out) at the end of years 3, 4 and 5 are also shown below.

	Fair value	Intrinsic value
Year 1	CU14.40	
Year 2	CU15.50	
Year 3	CU18.20	CU15.00
Year 4	CU21.40	CU20.00
Year 5		CU25.00

APPLICATION OF REQUIREMENTS

	CU
Year 1	
Expense for services received and consumed, and the liability at the year-end 450 employees × 100 SARs × CU14.40 × 1/3 =	216,000
Expense for an equivalent equity-settled transaction (450 + (50 × 0.5)) units of service × CU444.44 =	211,109
Amount to disclose under paragraph 52(b)	4,891
Year 2	
Liability at year-end 410 employees × 100 SARs × CU15.50 × 2/3 =	423,667
Less liability at start of year	(216,000)
Expense for year	207,667
Expense for an equivalent equity-settled transaction (410 + (40 × 0.5)) units of service × CU444.44 =	191,109
Amount to disclose under paragraph 52(b)	16,558
Year 3	
Liability at year-end 240 employees × 100 SARs × CU18.20 =	436,800
Less liability at start of year	(423,667)
Plus cash paid on exercise of SARs by employees 150 employees × 100 SARs × CU15.00 =	225,000
Expense for year	238,133
Expense for an equivalent equity-settled transaction (390 + (20 × 0.5)) units of service × CU444.44 =	177,776
Amount to disclose under paragraph 52(b)	60,357

	CU
Year 4	
Liability at year-end 100 employees × 100 SARs × CU21.40 =	214,000
Less liability at start of year	(436,800)
Plus cash paid on exercise of SARs 140 employees × 100 SARs × CU20.00 =	280,000
Expense for year	57,200
Expense for an equivalent equity-settled transaction	0
Amount to disclose under paragraph 52(b)	57,200
Year 5	
Liability at year-end	0
Less liability at start of year	(214,000)
Plus cash paid on exercise of SARs 100 employees × 100 SARs × CU25.00 =	250,000
Expense for year	36,000
Expense for an equivalent equity-settled transaction	0
Amount to disclose under paragraph 52(b)	36,000

Appendix D
Disclosures

This appendix is an integral part of the [draft] IFRS

The following example illustrates the disclosure requirements in paragraphs 45-53 of the [draft] IFRS.*

Extract from the Notes to the Financial Statements of Company Z for the year ended 31 December 2004.

Share-based Payment

During the period ended 31 December 2004, the Company had four share-based payment arrangements, which are described below.

Share options - Arrangement 1

On 15 December 2002 the Company granted 1,000 options to each of 50 employees at senior management level. The exercise price of the options was fixed at the date of grant, and the options have a contractual life of 10 years. The options granted were conditional upon the employees' remaining in the Company's employ for two years from the date of grant, and the Company's share price increasing by 10 per cent by 15 December 2004. This performance target was achieved.

Share options - Arrangement 2

On 1 January 2004 the Company granted 100 options to each of its 750 employees below senior management level, provided they remain in the Company's employ for three years. The exercise price of the options was fixed at the date of grant, and the options have a contractual life of 10 years. The Company estimated the fair value of each option granted at CU18.81. This was calculated by applying a Black-Scholes option pricing model and then adjusting the value produced by that model for the weighted average possibility

* Note that the illustrative example is not intended to be a template or model and is therefore not exhaustive. For example, it does not illustrate the disclosure requirements in paragraphs 48(d), 49 and 50 of the [draft] IFRS.

of forfeiture, which the Company estimated at 20 per cent. The model inputs were the share price at grant date of CU60, exercise price of CU60, expected volatility of 40 per cent, expected dividend yield of 1 per cent, expected life of 5 years, and the risk-free interest rate of 5 per cent. Historical volatility was 45 per cent, which includes the early years of the Company's life; the Company expects the volatility of its share price to reduce as it matures. The risk-free interest rate is equal to the implied yield on zero-coupon government bonds available at grant date in Country X with a remaining term of 5 years. The option grant includes a reload feature, which provides for an automatic grant of additional options whenever an employee uses the Company's shares rather than cash to satisfy the exercise price of previously granted options. The value of this reload feature has not been included in the estimate of the fair value of the options granted, because it is impracticable to do so in the circumstances, owing to significant uncertainties relating to, amongst other things, the expected timing and number of reload options granted. Instead, any reload options subsequently granted will be accounted for as a new option grant.

Shares

On 15 December 2004 the Company granted 500 shares to 10 executive staff, conditional upon the executives' remaining in the Company's employ until 31 December 2006 and the Company achieving a 12 per cent growth in earnings per share by that date. The Company estimated the fair value of each share granted at CU55.46. This was determined by adjusting the share price of CU65 at the date of grant for expected dividends of CU1.25 per share and the weighted average possibility of forfeiture due to failure to satisfy the vesting conditions, which the Company estimated at 13 per cent.

Share appreciation rights

On 1 January 2004 the Company granted 500 share appreciation rights to each of 50 employees at senior management level, whereby the employees will be entitled to a cash payment, equal to the increase in the Company's share price from CU60, if they remain in the Company's employ for three years from the date of grant. The share appreciation rights have a contractual life of 10 years from the date of grant. The Company estimated the fair value of each share appreciation right granted at CU19.75. This was calculated by applying the Black-Scholes option pricing model and adjusting the value produced by that model for the weighted average possibility of forfeiture, which the Company estimated at 16 per cent. The inputs to the model were the share price of CU60, exercise price of CU60, expected life of 5 years, expected volatility of 40 per cent, expected dividend yield of 1 per cent and risk-free interest rate of 5 per cent. Historical volatility was 45 per cent, which the Company expects to reduce to 40 per cent, for the reasons explained above. The risk-free interest rate was determined as explained above.

Further details of the two share option arrangements are as follows:

	2003		2004	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Outstanding at start of year	50,000	CU50	45,000	CU50
Granted	0	-	75,000	CU60
Forfeited	(5,000)	CU50	(8,000)	CU56
Exercised	0	-	(4,000)	CU50
Outstanding at end of year	45,000	CU50	108,000	CU56
Exercisable at end of year	0	CU50	38,000	CU50

The weighted average share price at the date of exercise for options exercised during the period was CU65. These options had an actual life of 2 years. The expected life of the option arrangement, under which 50,000 options were granted, is 5.5 years. During the period, 84 per cent of the options granted under Option Arrangement 1 vested, compared with the grant date estimate of 90 per cent. The options outstanding at 31 December 2004 had an exercise price of CU50 or CU60, a weighted average remaining expected life of 4.15 years and a weighted average contractual life of 8.63 years. The total expense recognised during the period in respect of share-based payment transactions was CU1,086,417 (2003: CU399,950), of which CU903,274 (2003: CU399,950) arises from transactions in which equity instruments (options and shares) were granted. During the period CU8,349 (2003: nil) was recognised as an expense resulting from an increase in the fair value of the liability, since grant date, for the share appreciation rights granted.

Appendix E
Amendments to other IFRSs

The amendments in this [draft] appendix become effective for accounting periods beginning on or after 1 January 2004 [provided that the IFRS is issued before the end of 2003]. If an entity applies this [draft] IFRS for an earlier period, these amendments become effective for that earlier period.

E1 A new paragraph 1(f) is inserted into IAS 32 (revised 200X) *Financial Instruments: Disclosure and Presentation*:

"financial instruments, contracts and obligations under share-based payment transactions to which IFRS [X] *Share-based Payment* applies, except for

(i) contracts within the scope of paragraphs 4A and 4B of this Standard, to which this Standard applies,

(ii) paragraphs 29A and 29B of this Standard, which shall be applied to treasury shares purchased, sold, issued or cancelled in connection with employee share option plans, employee share purchase plans, and all other share-based payment arrangements."

E2 A new paragraph 1(j) is inserted into IAS 39 (revised 200X) *Financial Instruments: Recognition and Measurement*:

"financial instruments, contracts and obligations under share-based payment transactions to which IFRS [X] *Share-based Payment* applies, except for contracts within the scope of paragraphs 6 and 7 of this Standard, to which this Standard applies."

E3 IAS 19 (revised 2000) *Employee Benefits* is amended as follows:

(a) In the Introduction:

(i) Paragraph 2 is amended:

"The Standard identifies four categories of employee benefits:"

(ii) Paragraph 2(e) is deleted, together with "; and" at the end of paragraph 2(d).

(iii) Paragraph 11 is deleted.

(b) Paragraph 1 is amended:

"***This Standard should be applied by an employer in accounting for all employee benefits, except those to which IFRS [X] Share-***

based Payment applies."

(c) Paragraph 3 is amended:

"The employee benefits to which this Standard applies include those provided…"

(d) Paragraph 4(e) is deleted, together with "; and" at the end of paragraph 4(d).

(e) In paragraph 4 the final sentence is amended:

"Because each category identified in (a) to (d) above has different characteristics…"

(f) In paragraph 7 the definitions of *equity compensation benefits* and *equity compensation plans* are deleted.

(g) In paragraph 7 the definitions of *short-term employee benefits*, *post-employment employee benefits*, and *other long-term employee benefits* are amended by deleting the references to equity compensation benefits.

(h) In paragraph 22 the final sentence is deleted.

(i) Paragraphs 144–152 are deleted.

(j) In Appendix B the illustrative disclosures under the heading *Equity Compensation Benefits* are deleted.

(k) In Appendix C, paragraph 3(m) of the Basis for Conclusions is amended:

"…certain similar post-employment benefits (see paragraphs 86-93 below); and"

(l) In Appendix C, paragraph 94 of the Basis for Conclusions is deleted.

E4 In IAS 33 (revised 200X) *Earnings per Share*:

(a) insert a new paragraph 43A:

"For share options and other share-based payment arrangements to which IFRS [X] *Share-based Payment* applies, the issue price referred to in paragraph 42 above and the exercise price referred to in paragraph 43 above shall include the fair value of any goods or services to be supplied to the entity in the future under the share option or other share-based payment arrangement."

(b) insert a new Example 6A in Appendix B:

"**Example 6A – Determining the Exercise Price of Employee Share Options**

Weighted average number of unvested share options per employee	1,000
Weighted average length of remaining vesting period	2 years
Weighted average deemed fair value of each unit of employee service to be rendered as consideration for the share options, determined in accordance with IFRS [X] *Share-based Payment*	600
Cash exercise price of unvested share options	15

Calculation of adjusted exercise price

Fair value of services yet to be rendered per employee: (600 × 2 years)	1,200
Fair value of services yet to be rendered per option: (1,200/1,000)	1.20
Total exercise price of share options: (15.00 + 1.20)	16.20"

E5 In IAS 12 (revised 2000) *Income Taxes* a new example is inserted into Appendix B:

Example 5 – Share-based Payment Transactions

In accordance with IFRS [X] *Share-based Payment*, an entity has recognised an expense for the consumption of employee services received as consideration for share options granted. A tax deduction will not arise until the options are exercised, and the deduction is based on an option's intrinsic value at exercise date.

The difference between the tax base of the employee services received to date (being the amount the taxation authorities will permit as a deduction in future periods in respect of those services), and the carrying amount of nil, is a deductible temporary difference that results in a deferred tax asset.

The entity's tax rate is 40 per cent. The options were granted at the start of year 1, vested at the end of year 3 and were exercised at the end of year 5. Details of the expense recognised for employee services received and consumed in each accounting period, the number of options outstanding at each year-end, and the intrinsic value of the options at each year-end, are as follows:

	Employee services expense	Number of options at year-end	Intrinsic value per option
Year 1	200,000	50,000	5
Year 2	185,000	45,000	8
Year 3	175,000	40,000	12
Year 4	0	40,000	17
Year 5	0	40,000	20

The entity recognises a deferred tax asset and deferred tax income in years 1-4 and current tax income in year 5 as follows.

Year 1

Deferred tax asset and deferred tax income (50,000 × 5 × 1/3* × 0.40) =	33,333

*Because the tax base of the employee services received is based on the intrinsic value of the options, and those options were granted for three years' services, but only one year's services have been received to date, it is necessary to multiply the option's intrinsic value by one-third to arrive at the tax base of the employee services received in year 1.

Year 2

Deferred tax asset at year-end (45,000 × 8 × 2/3 × 0.40) =	96,000
Less deferred tax asset at start of year	(33,333)
Deferred tax income for year	62,667*

*This amount consists of the following:

Deferred tax income for the temporary difference between the tax base of the employee services received during the year and their carrying amount of nil: (45,000 × 8 × 1/3 × 0.40)	48,000
Tax income resulting from an adjustment to the tax base of employee services received in previous years:	
(a) increase in intrinsic value: (45,000 × 3 × 1/3 × 0.40)	18,000
(b) decrease in number of options: (5,000 × 5 × 1/3 × 0.40)	(3,333)
Deferred tax income for period	62,667

Year 3

Deferred tax asset at year-end (40,000 × 12 × 0.40) =	192,000
Less deferred tax asset at start of year	(96,000)
Deferred tax income for year	96,000

Year 4

Deferred tax asset at year-end (40,000 × 17 × 0.40) =	272,000
Less deferred tax asset at start of year	(192,000)
Deferred tax income for year	80,000

Year 5

Deferred tax expense (reversal of deferred tax asset)	(272,000)
Current tax income based on intrinsic value of options at exercise date (40,000 × 20 × 0.40) =	320,000
Net of deferred tax expense and current tax income	48,000

Summary

	Income statement				Balance sheet
	Employee services expense	Current tax expense (income)	Deferred tax expense (income)	Total tax expense (income)	Deferred tax asset
Year 1	200,000	0	(33,333)	(33,333)	33,333
Year 2	185,000	0	(33,333)	(62,667)	96,000
Year 3	175,000	0	(96,000)	(96,000)	192,000
Year 4	0	0	(80,000)	(80,000)	272,000
Year 5	0	(320,000)	272,000	(48,000)	0

E6 IFRS [X] *First-time Application of International Financial Reporting Standards* is amended as follows:

(a) in paragraph 11, the reference to paragraphs 13-24 is changed to 13-24A.

(b) in paragraph 13, the references to paragraphs 14-24 are changed to 14-24A.

(c) in paragraph 14, the reference to paragraphs 16-24 is changed to 16-24A.

(d) paragraphs 14(a)(iii) and 14(a)(iv) are amended and a new paragraph 14(a)(v) is inserted, as follows:

“(iii) net employee benefit assets or liabilities under defined benefit plans (paragraph 22);

(iv) cumulative translation differences relating to a net investment in a foreign operation (paragraph 23); and

(v) assets and components of equity arising from share-based payment transactions (paragraph 24A).”

(e) A new paragraph 24A is inserted:

“The entity shall apply IFRS [X] *Share-based Payment* to shares, options or other equity instruments granted pursuant to a share-based payment arrangement that were granted after [date to be inserted, being the publication date of the Exposure Draft of the IFRS on share-based payment] and had not yet vested at the later of (a) the date of transition to IFRSs and (b) [date to be inserted, being the effective date of the IFRS on share-based payment]. However, the entity shall apply IFRS [X] retrospectively to liabilities arising from share-based payment transactions existing at the date of transition to IFRSs, except that the entity is not required to measure vested share appreciation rights (and similar liabilities in which the counterparty holds vested rights to cash or other assets of the entity) at fair value. Such liabilities shall be measured at their settlement amount (ie the amount that would have been paid in settlement of the liability had the counterparty demanded settlement at the date the liability is measured).”

(f) New paragraphs IG53, IG54 and IG55 are inserted into the [draft] Implementation Guidance:

“IG53 The entity applies IFRS [X] *Share-based Payment* to shares, options or other equity instruments granted pursuant to a share-based payment arrangement that were granted after [date to be inserted, being the publication date of the Exposure Draft of the IFRS on share-based payment] and had not yet vested at the later of (a) the date of transition to IFRSs and (b) [date to be inserted, being the effective date of the IFRS on share-based payment].

IG54 For example, if an entity’s date of transition to IFRSs is 1 January 2003, the entity applies IFRS [X] to shares, options or other equity instruments granted pursuant to a share-based payment arrangement that were granted after [date to be inserted, being the publication date of the Exposure Draft of the IFRS on share-based payment] and had not yet vested at [date to be inserted, being the effective date of the IFRS on share-based payment, which will be later than 1 January 2003]. Conversely, if an entity’s date of transition to IFRSs is 1 January 2010, the entity applies IFRS [X] to shares, options or other equity instruments granted pursuant to a share-based payment arrangement that were granted after [date to be inserted, being the publication date of the Exposure Draft of the IFRS on share-based payment] and had not yet vested at 1 January 2010.

IG55 However, the entity applies IFRS [X] retrospectively to liabilities arising from share-based payment transactions existing at the date of transition to IFRSs, except that the entity is not required to measure vested share appreciation rights (and similar liabilities in which the counterparty holds vested rights to cash or other assets of the entity) at fair value. Such liabilities are measured at their settlement amount (ie the amount that would have been paid in settlement of the liability had the counterparty demanded settlement at the date the liability is measured)."

E7 The definition of *cost* in paragraph 6 of IAS 16 (revised 200X) *Property, Plant and Equipment*, paragraph 7 of IAS 38 (1998) *Intangible Assets*, and paragraph 4 of IAS 40 (revised 200X) *Investment Property* is amended as follows:

"<u>Cost</u> is the amount of cash or cash equivalents paid or the fair value of other consideration given to acquire an asset at the time of its acquisition or construction, except that if an asset is received as consideration for equity instruments of the entity in a share-based payment transaction to which IFRS [X] *Share-based Payment* applies, the cost of the asset shall be determined in accordance with the measurement requirements in that IFRS."

E8 Paragraph 26 of IAS 38 is deleted.

Glossary

This Glossary is an integral part of the [draft] IFRS. It lists the terms that are used in this [draft] IFRS with a specific meaning. [When the final IFRS is included in the Bound Volume of IFRSs, this Glossary will be merged with the Glossary in the Bound Volume.]

cash-settled share-based payment transaction	A **share-based payment transaction** in which the entity acquires goods or services by incurring liabilities to the supplier of those goods or services for amounts that are based on the price (or value) of the entity's shares or other **equity instruments**.
equity instrument	A contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.
equity instrument granted	The right (conditional or unconditional) to an **equity instrument** of the entity conferred by the entity on another party, pursuant to a **share-based payment arrangement**.
equity-settled share-based payment transaction	A **share-based payment transaction** in which the entity receives goods or services as consideration for **equity instruments** of the entity (including shares or **share options**).
expected life	The period of time from **grant date** to the date on which an option is expected to be exercised.
fair value	The amount for which an asset could be exchanged, a liability settled, or an **equity instrument granted** could be exchanged, between knowledgeable, willing parties in an arm's length transaction.
grant date	The date at which the entity and another party (including an employee) agree to a **share-based payment arrangement**, being when the entity and the counterparty have a shared understanding of the terms and conditions of the arrangement. At grant date the entity confers on the counterparty

the right to cash, other assets, or **equity instruments** of the entity, provided the specified **vesting conditions**, if any, are met. If that agreement is subject to an approval process (for example, by shareholders), grant date is the date when that approval is obtained.

reload feature — A feature that provides for an automatic grant of additional **share options** whenever the option holder exercises previously granted options using the entity's shares, rather than cash, to satisfy the exercise price.

reload option — A new share option granted for a share used to satisfy the exercise price of a previous share option.

risk-free interest rate — The implied yield currently available on zero-coupon government issues, in the country in which the entity's shares are traded or principally traded (or, for an unlisted entity, the country in which the entity operates or principally operates), with a remaining term equal to the expected life of the option being valued.

share-based payment arrangement — An agreement between the entity and another party (including an employee) to enter into a **share-based payment transaction**, which thereby entitles the other party to receive cash or other assets of the entity for amounts that are based on the price of the entity's shares or other **equity instruments**, or to **equity instruments** of the entity, provided the specified **vesting conditions**, if any, are met**.**

share-based payment transaction — A transaction in which the entity receives goods or services as consideration for **equity instruments** of the entity (including shares or **share options**), or acquires goods or services by incurring liabilities to the supplier of those goods or services for amounts that are based on the price of the entity's shares or other **equity instruments**.

share option — A contract that gives the holder the right, but not the obligation, to subscribe to the entity's shares at a fixed or determinable price for a specified period of time.

unit of service — A standard measure of the quantity of services received or expected to be received from the counterparty to a **share-based payment transaction**, expressed in terms of a particular length of time. For example, a unit of service could be one month's service or one year's service. An entity selects a particular length of time that constitutes one unit of service, and applies it consistently for the purposes of [draft] IFRS [X] *Share-based Payment*.

vest — To become an entitlement. Under a **share-based payment arrangement**, a counterparty's right to receive cash, other assets, or equity instruments of the entity vests upon satisfaction of any specified **vesting conditions**.

vesting conditions — The conditions that must be satisfied for the counterparty to become entitled to receive cash, other assets or **equity instruments** of the entity, pursuant to 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 share price over a specified period of time).

vesting period — The period between **grant date** and the date upon which all the specified **vesting conditions** of a **share-based payment arrangement** are satisfied.

volatility — A measure of the amount by which a price has fluctuated (historical volatility) or is expected to fluctuate (expected volatility) during a period. The volatility of a share price is the standard deviation of the continuously compounded rates of return on the share over a specified period.