

IFRS 2 *Share-based payment*

The essential guide (updated March 2009)



An overview of IFRS 2 *Share-based payment*

Share-based payment awards (such as share options and shares) are a key issue for executives, entrepreneurs, employees, and directors. This guide gives an overview of IFRS 2 *Share-based payment* (IFRS 2 or the Standard) and related interpretations IFRIC 8 *Scope of IFRS 2* and IFRIC 11 *Group Treasury Share Transactions*. A glossary of terms relating to share-based payments is at the end of this document.

Background to IFRS 2

IFRS 2 was issued in February 2004 and prescribes the measurement and recognition principles for all share-based payment awards. IFRS 2 applies to transactions with employees and third parties, whether settled in cash, other assets (relatively uncommon, but for example, gold) or equity instruments. The Standard was recently amended with respect to vesting conditions and cancellations which became effective on 1 January 2009. The International Accounting Standards Board (IASB) is currently drafting an amendment with respect to group cash-settled awards.

IFRS 2 is one of the more challenging accounting standards since it involves complex valuation issues and, as described below, is sometimes counter-intuitive. The general principle of IFRS 2 is that an entity recognises an expense for goods or services (or an asset, if the goods or services received meet the criteria for recognising an asset) with the credit entry recognised either in equity or as a liability (depending on the classification of the share-based payment award). The definitions of 'equity' and 'liability' in IFRS 2 are very different from those used in IAS 32 *Financial Instruments: Presentation* and IAS 39 *Financial Instruments: Recognition and Measurement*.

The Standard requires entities to recognise all share-based payment awards in the financial statements based on fair value when the goods and services are received, which is determined at the grant date for share-based payments issued to employees. As share-based payment awards have become a larger component of employee and executive compensation (for example, in the Silicon Valley technology companies in the late 1990s), standard-setters came to believe that share-based payment awards are an integral component of a total compensation package. As such, they concluded that an entity should recognise an expense for share-based payments, just as it does for cash compensation.



After much debate, the IASB settled on a 'grant date' model. Under the grant date model in IFRS 2, an entity measures the fair value of a share-based payment award issued to an employee on the grant date. The entity does not adjust the fair value afterwards (even if it becomes more or less valuable or does not ultimately vest), unless the award is modified. Frequently, this results in an entity recognising an expense even if the employee receives no benefit. Thus, the Standard is somewhat counter-intuitive, as the accounting pendulum has swung from recognising no expense for awards that do have value, to frequently recognising expense for awards that ultimately do not have value. Although this situation is far from ideal, we believe that the current model is preferable to its predecessor, in which entities recognised no expense. We explore some of the basic concepts, including the grant date model, below.

Scope of IFRS 2

IFRS 2 encompasses:

- ▶ **Equity-settled share-based payment transactions** in which the entity receives goods or services and as consideration for equity instruments of the entity (e.g., the grant of shares or share options to employees)
- ▶ **Cash-settled share-based payment transactions** or 'liability awards' in which the entity receives goods or services and incurs a liability based on the price (or value) of the entity's shares or other equity instruments of the entity as consideration (e.g., the grant of share appreciation rights to employees, which entitle the employees to future cash payments based on the increase in the entity's share price)

- ▶ **Share-based payment transactions with cash alternatives** in which the entity receives goods or services and either the entity or the supplier of those goods or services (the counterparty) has a choice of settling the transaction in cash, other assets, or equity instruments

IFRS 2 is not restricted to transactions with employees. For example, if an external supplier of goods or services is paid in shares, share options or cash based on the price (or value) of shares or other equity instruments of the entity, IFRS 2 must be applied. Goods do not include financial assets, but do include inventories, consumables, property, plant and equipment, intangibles, and other non-financial assets.

Even if an entity cannot specifically determine the consideration (goods or services) it receives in return for its shares, it must apply IFRS 2. For example, if an entity grants shares to a charity for no identifiable benefit, that transaction is within the scope of IFRS 2.

IFRS 2 also applies to equity-settled awards that an entity's shareholders grant to parties (including employees) that supply goods or services to the entity. For example, this Standard applies to transfers of equity instruments of an entity's parent (or another entity in the same group), to parties that supply goods or services to the entity. The IASB has still to decide whether cash-settled awards granted by an entity's shareholder should also be within the scope of IFRS 2.

IFRS 2 does not cover the following transactions:

- ▶ Transfers of equity instruments that are clearly not payments for goods and services
- ▶ Transactions with shareholders as a whole, i.e., when the shareholders act solely in their capacity as shareholders
- ▶ Transactions within the scope of IAS 32 and IAS 39
- ▶ Share-based payment awards to acquire goods in the context of a business combination to which IFRS 3 *Business Combinations* (or IFRS 3R) applies.

However, awards granted to the employees of the acquiree in their capacity as employees (e.g., in return for continued service) are within the scope of IFRS 2, as are the cancellation, replacement or modification of share-based payment awards as a result of a business combination or other equity restructuring. The IASB proposed an amendment as a part of its Annual Improvements project that confirms that contributions of a business upon formation of a joint venture and common control transactions are also not within the scope of IFRS 2, even though they do not meet the definition of a business combination in IFRS 3 or IFRS 3R. If approved, the amendment will be effective for annual periods beginning on or after 1 July 2009, or upon the date of adoption of IFRS 3R, if earlier.



Recognition principle

As Box 1 below illustrates, IFRS 2 requires entities to recognise:

- ▶ An expense (or an asset if the goods and/or services received meet the criteria for recognising an asset)
- ▶ A corresponding increase in equity (for transactions settled in equity instruments) or in liabilities (for cash-settled transactions)

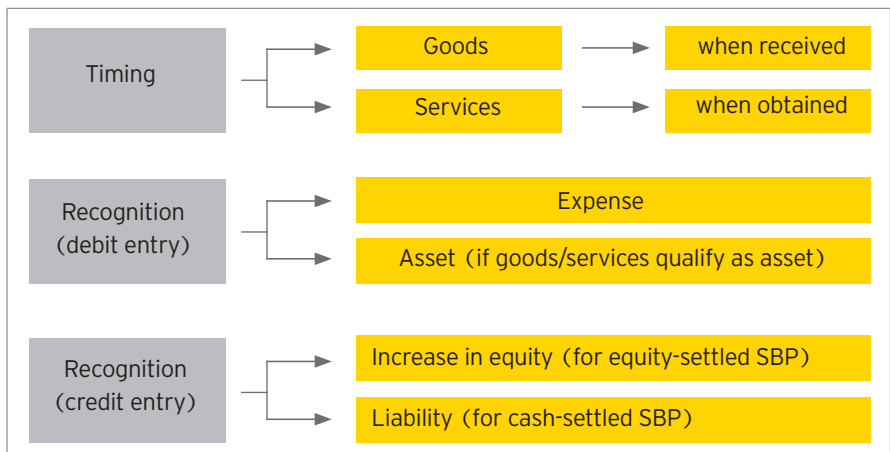
However, how and when the entity measures the expense, and whether the entity must remeasure the expense, all depend on whether the award is equity-settled, cash-settled, or there is a choice of settlement, as we explore in the remainder of this guide.

Equity-settled awards

Measurement principle

For equity-settled awards (such as share options), the general principle in IFRS 2 is that an entity measures the fair value of goods or services received and recognises a corresponding increase in equity. But, if an entity cannot reliably estimate the fair value of goods or services received, the entity must measure their value indirectly using the fair value of the equity instruments granted.

Box 1: Recognition of share-based payments





However, IFRS 2 states that:

- ▶ For awards to **employees**, an entity must use the fair value of the equity instruments, measured at the grant date
- ▶ For awards to **non-employees**, there is a rebuttable presumption that the fair value of the goods or services is more reliably determinable, measured when the goods or services are received

The IASB's decision to require entities to measure the fair value of equity instruments issued to employees based on the fair value of the equity instruments is practical rather than theoretical, in that entities might have difficulty establishing which services relate to which component of an employee's compensation package. Furthermore, if a share-based payment award serves as a bonus, the entity pays additional compensation to receive additional services, but it may be difficult to determine the value of such services.

As there are no quoted market prices for most share-based payment awards, IFRS 2 requires entities to estimate the fair value of their share-based payment awards using option-pricing models, which we discuss in more detail in the following pages.

For a transaction in which no specifically identifiable goods and services are received (e.g., donation of shares to a charity), the entity recognises the difference between the fair value of the share-based payment award and the fair value of any identifiable goods or services (to be) received as an expense. This requirement also applies to transactions in which the fair value of the goods or services received is less than the fair value of the equity instruments granted or liability incurred.

Box 2 illustrates the measurement principle for equity-settled awards:

Box 2: Measurement of share-based payments

Counterparty	Measurement basis	Measurement date	Recognition date
Employee	Fair value of equity instruments awarded	Grant date	Date goods or services received
Non-employee	Fair value of goods or services received	Date goods or services received	Date goods or services received

Determination of grant date

As noted in the discussion above, the determination of grant date is critical to the measurement of equity-settled share-based transactions with employees, since grant date is the date at which the entity measures such transactions.

Grant date is defined as the date on which the reporting entity and the counterparty have a 'shared understanding of the terms of the arrangement.'

In practice, the following issues can arise:

- ▶ How precise the shared understanding of the terms of the award must be
- ▶ What level of communication between the reporting entity and the counterparty is sufficient to ensure the appropriate degree of 'shared understanding'

The implementation guidance to IFRS 2 indicates that the 'grant date' is when there is a mutual understanding of the terms and a legally enforceable arrangement. Thus, if an award requires board or shareholder approval for it to be legally binding on the reporting entity, under IFRS 2 the grant date is not until such approval has been given, even if the terms of the award are fully understood at an earlier date. However, if the employee is rendering services for the award beginning at a date earlier than the grant date, the entity estimates the cost of the award and recognises such cost over a period starting with that earlier date. The entity then adjusts the cost estimate to the grant date fair value when approval is given and the grant date is set.



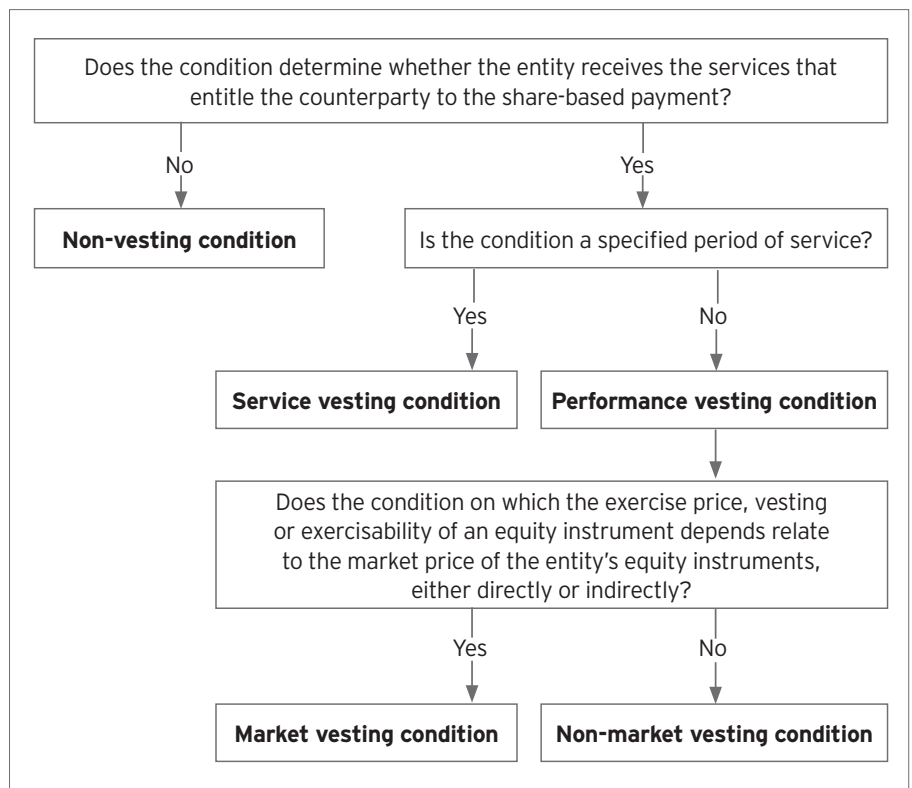
Vesting and non-vesting conditions

A share-based payment award generally vests upon meeting specified conditions, such as service conditions (time-based) or performance conditions (e.g., achieving a specified EBITDA target). Under IFRS 2, the nature of the condition affects the timing of when the expense is recognised, and in some cases, the measurement of the expense. In addition, if a condition is not met, whether or not the entity may reverse the previously recognised compensation expense depends on the nature of the

condition that was not met. Therefore, the classification of a condition is a critical step in accounting for share-based payments. The recent amendment to IFRS 2 *Vesting Conditions and Cancellations* clarified the meaning of 'vesting condition' and introduced the concept of a 'non-vesting condition' (see Glossary).

As the decision tree in Box 3 illustrates, the difference between a vesting condition and a non-vesting condition is dependent upon whether or not the entity receives services. It is possible that the counterparty does not receive or 'vest' in the award (because non-vesting conditions are not met).

Box 3: Classification of conditions to receive share-based payments





Impact of conditions on measuring share-based payments

In addition to affecting the timing of the expense recognition, vesting conditions may also affect the measurement of the award, depending on the type of condition. IFRS 2 states that:

- ▶ **Market conditions** (e.g., minimum increase in share price) are taken into account in valuing the award at grant date. The entity recognises an expense irrespective of whether the market condition is satisfied, if all vesting conditions are satisfied. Therefore, as shown in Example 1, it is possible for an entity to incur expense even when the market condition is not met and the counterparty does not receive the award.
- ▶ **Non-vesting conditions** (e.g., requirement for the employee to make investments in employer shares) are accounted for as if they were market conditions and are only taken into account to determine the fair value of the equity instruments. Therefore, as shown in Example 2, similar to awards that are subject to a market condition, the entity recognises an expense irrespective of whether the non-vesting condition is satisfied, if all non-market vesting conditions are satisfied.
- ▶ **Non-market vesting conditions and service vesting conditions** (e.g., achievement of sales target or any service conditions), in contrast, are not considered when determining the fair value of the equity instruments. Rather, they are considered when an entity recognises an expense for goods and services received during the vesting period based on its best estimate (revised each reporting period) of the equity instruments that will vest.

Accounting for share-based payments with conditions

Example 1: Award with market condition only

An entity granted share options to a director on the condition that the market price of the related shares increases by at least 15% each year over the next five years. At the end of year five, this target was not met.

The entity cannot reverse the expense recognised in the current or previous years and cannot revise the grant date fair value since the condition is market-based.

Example 2: Award with non-vesting condition only

An entity grants share options to a director on the condition that the director does not compete with the reporting entity for a period of at least three years. The fair value of the award at the date of grant, including the effect of the 'non-compete' clause, is €150,000.

The 'non-compete' clause is a non-vesting condition, because the entity does not receive any services. On the grant date, the entity immediately recognises a cost of €150,000, as the director is not providing any future services. The entity cannot reverse the expense recognised, even if the director goes to work for a competitor and loses the share options, because the condition is a non-vesting condition.

Box 4 illustrates when an entity recognises expense if an award contains multiple conditions that must all be met in order for the award to vest:

Box 4: Recognising expense for an award with multiple conditions

	Service condition met?	Market condition met?	Non-market performance condition met?	IFRS 2 expense?
1	Yes	Yes	Yes	Yes
2	Yes	No	Yes	Yes
3	Yes	Yes	No	No
4	Yes	No	No	No
5	No	Yes	Yes	No
6	No	No	Yes	No
7	No	Yes	No	No
8	No	No	No	No

As a result, an entity recognises cost for goods and services received when all service and non-market vesting conditions are met, regardless of whether the market conditions or non-vesting conditions are met.



Vesting period

A vesting period is the period during which all the specified vesting conditions of a share-based payment award must be satisfied, which is not the same as the exercise period or the life of the option. An entity recognises expense over the vesting period, as shown in Example 3, or immediately, if none.

Example 3: Award with service condition only

If an employee remains in service for at least three years from the grant date of the award, the employee can exercise the options at any time between three and ten years from the grant date of the award. The fair value of the award at the grant date, ignoring the effect of the vesting condition, is €300,000.

For this award, the vesting period is three years, the exercise period is seven years, and the life of the option is ten years.

The requirement to remain employed is a (vesting) service condition. The entity recognises an expense of €100,000 a year for three years, with a corresponding increase in equity. If the employee leaves at the end of year two, the entity reverses the cumulative expense previously recognised (i.e., €200,000) in the current year.

Share-based payment awards frequently have one grant date and different vesting periods. An entity must separately determine the fair value of each award with a different vesting period and recognise the expense over the vesting period, as shown in Example 4. This requirement differs significantly from the requirement under some local GAAPs, which permit an entity to value the share-based payment award as one award and recognise the expense on a straight-line basis over the vesting period.

Example 4: Award with multiple vesting periods

On 1 January 2009, an entity grants an award to an executive for 40,000 share options, such that 10,000 share options vest (or are forfeited) in each of the next four years depending on whether the executive is employed at the end of that year. At 1 January 2009, a mutual detailed understanding of the key terms and conditions is reached.

There is one grant date - 1 January 2009 (and therefore one measurement date) for multiple service periods. This award has a graded vesting pattern whereby the 2009 tranche has a one-year vesting period, the 2010 tranche has a two-year vesting period, the 2011 has a three-year vesting period, and the 2012 tranche has a four-year vesting period.

If the fact pattern were altered such that performance targets were set on 1 January of each respective year, each tranche of options would have a 1 January grant date and a one-year vesting period.



Under IFRS 2, an entity only recognises compensation expense for options with non-market performance conditions if such awards ultimately vest. Therefore, if an entity grants options to a large number of employees on one grant date, the entity might estimate the number of employees that will terminate employment prior to meeting the non-market performance conditions, i.e., the number of employees that will forfeit awards. The entity adjusts its estimate of awards that will vest at each reporting date so that on the vesting date, the expense recognised equals the grant date fair value of the options that have vested, as shown in Example 5.

Example 5: Changes in estimates

An entity grants 100 share options to each of its 500 employees. Vesting is conditional upon the employees working for the entity over the next three years. The entity estimates that the fair value of each share option is €15. On the grant date, the entity estimates that 15% of the original 500 employees will leave before the end of the vesting period. However, 20 employees leave during the first year, and the entity's best estimate at the end of year 1 is still that 15% of the original 500 employees will leave before the end of the vesting period. During the second year, a further 22 employees leave, and the entity revises its estimate of total employee departures over the vesting period from 15% to 12% of the original 500 employees. During the third year, a further 15 employees leave. Therefore, 57 employees (20 + 22 + 15) forfeit their rights to the share options during the three-year period, and 44,300 share options (443 employees × 100 options per employee) finally vest.

The entity recognises the following expense:

	Cumulative expense	Expense for period
Year 1 : 50,000 options x 85% x €15 x 1/3 vesting period	€212,500	€212,500
Year 2 : 50,000 options x 88% x €15 x 2/3 vesting period	€440,000	€227,500
Year 3: 44,300 options x 100% x €15 x 3/3 vesting period	€664,500	€224,500



Valuation

Unless an option with the same or comparable terms is listed (which rarely occurs) an entity cannot obtain the fair value externally. Therefore, it must estimate the fair value of a share-based payment using an option-pricing model. IFRS 2 does not require entities to use a specific option-pricing model to calculate fair value. However, it does require that the adopted valuation technique is consistent with generally accepted valuation methodologies for pricing financial instruments, incorporating all factors and assumptions that knowledgeable, willing market participants would normally consider with respect to that particular award. The Basis for Conclusions to IFRS 2 specifically

mentions the Black-Scholes-Merton and Binomial Models as two acceptable methods that entities might use when estimating the fair value of employee share options. For awards that include a market condition or the market value of the entity's equity in a performance condition, such as total shareholder return, an entity should use a technique such as Monte Carlo Simulation to estimate the likelihood that a market condition will be reached, and the resulting value of the award.

IFRS 2 requires that at a minimum, the entity must use six inputs in whichever model is selected. Box 5 illustrates the effects that an increase in any of the six different inputs has on the fair value of the option (all other terms remaining constant):

Box 5: Impact of an increase in an input into a valuation model

	FV increase	FV decrease
Exercise price of the option		■
Current share price	■	
Expected life of the option	■	
Expected volatility	■	
Expected dividend yield		■
Risk-free interest rate	■	

Of the six required inputs above, only two - the exercise price of the option and the current share price - are objectively determinable. The remaining assumptions are subjective and generally require significant analysis and judgment, including consideration of the following factors:

- ▶ **Expected life of the option:** the vesting period, past history of employee exercise, the price of the underlying shares, the employee's level within the organisation and the expected volatility
- ▶ **Expected volatility:** (a measure of the amount by which a share price has fluctuated during a given period) the historical volatility over the same period

as the expected life of the option, long-term average level of volatility, the length of time an entity's shares have been publicly traded, and the appropriate interval for price observations

- ▶ **Expected dividend yield:** (if an employee is not entitled to dividends on the underlying shares while holding the share option) the current expectation about an entity's dividend policy
- ▶ **Risk-free interest rate:** the implied yield currently available on zero-coupon government issues denominated in the currency of the market in which the underlying shares primarily trade, over the same period as the expected life of the option



Cash-settled awards

For cash-settled awards (such as a share appreciation right), the general principle in IFRS 2 is that an entity measures the fair value of the goods or services received based on the fair value of the liability. However, unlike the 'grant date' model for equity-settled awards for employees, an entity remeasures the fair value of the award at each reporting period date and on settlement. The ultimate cost of a cash-settled award is the cash paid to the counterparty, which is the fair value at settlement date. Until the award is settled, an entity presents the cash-settled award as a liability and not within equity.

The entity recognises the services received and the liability for those services as the employees render them. If an employee is not required to provide any service, as is the case for some share appreciation rights, the entity recognises the expense and liability immediately upon grant date. If the employee is required to provide services over for a specified period in order to vest in the cash-settled award, the entity recognises the expense and the liability over the vesting period, while reconsidering the likelihood of achieving vesting conditions and remeasuring the fair value of the liability at the end of each reporting period.

Modifications, cancellations and settlements

An entity sometimes modifies or cancels share-based payment awards before they actually vest because the vesting conditions become too onerous to achieve, or the share price of an option has dropped so far below the exercise price that it is unlikely it will ever be 'in the money' during its life. An entity may replace the original vesting conditions of the share-based payment award with less onerous conditions, making the award easier to attain.

If an entity modifies an award, it must recognise, at a minimum, the cost of the original award as if it were not modified. If the modification increases the fair value of the award, the entity must recognise that additional cost. The additional cost is spread over the period from the modification date until the vesting date of the modified options, which may differ from the vesting date of the original award. Whether a modification increases or decreases the fair value of an award is determined at modification date. If an entity modifies a vested option, it recognises any additional fair value given on the modification date.

When an award is cancelled or settled:

- ▶ If the cancellation or settlement occurs during the vesting period, it is treated as an acceleration of vesting and the entity immediately recognises the remaining amount that it otherwise would have recognised for services over the remaining vesting period.
- ▶ If an entity grants new awards during the vesting period and, on the grant date identifies the award as replacing the cancelled or settled award, the entity accounts for the new award as if it were a modification of the cancelled award. Otherwise, it accounts for the new award as an entirely new award.

Example 6: Award that is cash-settled

An entity grants 100 cash-settled awards to each of its 500 employees, on condition that the employees remain in its employment for the next three years. Cash is payable at the end of three years based on the share price of the entity's shares on such date.

During year 1, 35 employees leave. The entity estimates that 60 additional employees will leave during years 2 and 3 (i.e., the award will vest for 405 employees). The share price at year-end is €14.40.

During year 2, 40 employees leave and the entity estimates that 25 additional employees will leave during year 3 (i.e., the award will vest for 400 employees). The share price at year-end is €15.50.

During year 3, 22 employees leave, so that the award vests for 403 employees. The share price at year-end is €18.20.

The entity recognises the cost of this award as follows:

Year	Calculation of liability	Liability (€)	Expense for period (€)
1	405 employees x 100 awards x €14.40 x 1/3	194,400	194,400
2	400 employees x 100 awards x €15.50 x 2/3	413,333	218,933
3	403 employees x 100 awards x €18.20 x 3/3	733,460	320,127



In some cases, it is difficult to distinguish between forfeiture and a cancellation. For example, an unvested share-based payment award that expires upon termination of employment by the employer could be argued to be either a forfeiture (i.e., reversal of the cost of the award already recognised) or a cancellation (i.e., acceleration of the cost of the award not yet recognised). IFRS 2 appears to support both views. Therefore, entities must determine their accounting policy and apply it consistently.

There are additional practical difficulties if the award includes a non-market performance condition. IFRS 2 requires an entity to determine a cumulative charge at each reporting date based on its 'best available estimate' of the number of awards that will vest. However, that guidance seems to conflict with the requirement upon cancellation to recognise the amount that 'otherwise would have been recognised for services received over the remainder of the vesting period.' It is unclear whether the entity's best estimate at the date of cancellation encompasses employees at the cancellation date, or employees that would have vested if the award was not cancelled (that is, considering forfeitures that otherwise still might have occurred over the remaining vesting period). It is also unclear whether the entity's best estimate reflects the number of awards expected to vest based on progress towards achieving non-market performance conditions as of the cancellation date (or lack of progress), or the total awards that otherwise could have vested (that is, the maximum grant). IFRS 2 appears to support various views. Therefore, entities must determine their accounting policy and apply it consistently.

Share-based payment awards with a cash alternative

IFRS 2 gives specific guidance when cash-settlement is an election. The accounting differs depending on whether the choice rests with the counterparty or the entity.

If a counterparty can choose settlement in either shares or cash, IFRS 2 treats the award as a compound award, which is split into a liability component (the counterparty's right to demand settlement in cash) and an equity component (the counterparty's right to demand settlement in shares). Once split, the entity accounts for the two components separately.

If an entity chooses the settlement method, it treats the whole award either as cash-settled or as equity-settled, depending on whether or not the entity has a present obligation to settle in cash, which results in accounting for the award as a liability.

An entity has a present obligation to settle in cash, if any of the following apply:

- ▶ The choice of settlement has no commercial substance (e.g., because an entity is prohibited by law from issuing shares)
- ▶ An entity has a past practice or stated policy of settling in cash
- ▶ An entity generally settles in cash whenever the counterparty asks for cash settlement

If an entity does not have a present obligation to settle in cash, it is an equity-settled award.



Group share-based payment plans

A parent might grant equity-settled awards to employees of its subsidiary. For an equity-settled award in the consolidated financial statements of the parent, the subsidiary accounts for the services received from its employees as an equity-settled award in its own financial statements.

A subsidiary might grant rights to equity instruments of its parent to its employees. The subsidiary accounts for the transaction with its employees as cash-settled. This requirement applies irrespective of how a subsidiary obtains the equity instruments to satisfy its obligation to its employees.

Currently, the IASB is discussing whether cash-settled awards granted by an entity's shareholder (including a parent) to parties that supply goods or services to the entity fall within the scope of IFRS 2 and if so, how to account for such awards. In December 2008, the IASB tentatively agreed that if an entity (e.g., subsidiary) receives goods or services from its suppliers, it must apply IFRS 2, even though it itself has no obligation to make the required share-based cash payments. The entity (subsidiary) measures the goods or services from its suppliers based on the requirements for cash-settled awards.

Taxes on share-based payment awards

IAS 12 *Income Taxes* deals with the tax implications of accounting for share-based payment awards. However, due to differences in local tax laws, the tax implications arising from IFRS 2 are country-specific.

In many jurisdictions, entities receive tax deductions for share-based payment awards. For example, jurisdictions might give a tax deduction based on the following:

- ▶ Fair value of the award at the vesting date
- ▶ Fair value of the award at the date of exercise
- ▶ Amount charged to a subsidiary by its parent

In any case, both the amount and timing of the expense for tax purposes probably differ from the amount and timing of the expense recognised under IFRS 2, which results in deferred tax consequences as described in IAS 12.

Disclosure

IFRS 2 requires entities to disclose the following:

- ▶ The type and scope of agreements existing during the reporting period.
- ▶ Description of agreements (settlement methods, vesting conditions, etc.).
- ▶ The number and weighted-average exercise price of share options by category (outstanding at the beginning of the reporting period and at the end of the reporting period, granted, vested, exercised and forfeited).
- ▶ Average share price of exercised options
- ▶ Range of exercise prices and remaining contractual life of options outstanding at the end of the reporting period.
- ▶ Valuation method used to estimate the fair value of the awards (model and input values, etc.).
- ▶ The impact on the income statement (i.e., total expense) and the financial position (e.g., carrying amount of liabilities) of share-based payment awards.

Sample disclosures can be found in the implementation guidance for IFRS 2, or in our illustrative financial statements, Good Group (International) limited, which can be found on our website at www.ey.com/ifrs.



Transition to IFRS

IFRS 1 *First-time Adoption of International Financial Reporting Standards* sets out the transitional provisions for entities adopting IFRS for the first time.

Under IFRS 1, IFRS 2 is applicable for equity settled awards granted after 7 November 2002 (publication date of the Exposure Draft of IFRS 2) that have not vested as of the transition date to IFRS. However, entities must make some disclosures about outstanding awards for which it has not applied IFRS 2 (such as the number outstanding and weighted-average exercise price).

Under IFRS 1, IFRS 2 is applicable to cash-settled awards that are settled on or after the date of transition to IFRS. A first-time adopter is encouraged, but not required, to apply IFRS 2 to cash-settled awards that were settled before the date of transition to IFRS.

Summary

It is crucial that those involved in structuring plans are familiar with IFRS 2 and the related expense ramifications. As discussed above, vesting conditions affect the expense charged to the income statement differently. If an option has a market vesting condition or a non-vesting condition, an entity might still recognise an expense even if that condition is not attained and the option does not vest. By contrast, an award subject only to a non-market vesting condition does not result in an IFRS 2 expense if the condition is not met.

Decision-makers must also consider 'hidden' share-based payment awards, which may fall within the scope of IFRS 2 such as a situation in which:

- ▶ A non-corporate shareholder of an entity gives shares to employees of the entity
- ▶ Employees receive a cash payout equal to the increase in an index of shares
- ▶ An entity gives an employee a limited-recourse loan to acquire shares

Entities offering share-based payment awards should keep abreast of new developments and involve accounting, tax and human resource professionals. We recommend that you seek professional assistance when structuring plans.



IFRS 2 Glossary

Cash-settled share-based payment transaction

A share-based payment transaction in which an entity acquires goods or services by incurring a liability to transfer cash or other assets 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 of the entity.

Equity-settled share-based payment transaction

A share-based payment transaction in which an entity receives goods or services as consideration for equity instruments of the entity (including shares or share options).

Grant date

The date at which an entity and another party (including an employee) agree to a share-based payment arrangement, beginning 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, if the specified vesting conditions, if any, are met. If that agreement is subject to an approval process (e.g., by shareholders) the grant date is the date when that approval is obtained.

Intrinsic value

The difference between the fair value of the shares to which the counterparty has the conditional or unconditional right to subscribe, or to which it has the right to receive, and the price the counterparty is required to pay for those shares. For example, a share option with an exercise price of €15 per share with a fair value of €20 has an intrinsic value of €5.

Market condition

The condition upon which the exercise price, vesting or exercisability of an equity instrument depends is related to the market price of the entity's equity instruments, directly or indirectly. For example, attaining a specified share price, a specified intrinsic value, or achieving a specified target that is based on the market price of the entity's equity instruments, relative to an index.

Measurement date

The date at which the fair value of the equity instruments granted is measured for the purposes of this standard. For transactions with employees and others providing similar services, the measurement date is the grant date. For transactions with parties other than employees (and those providing similar services), the measurement date is the date the entity obtains the goods or the counterparty renders service.

Non-vesting conditions

Any condition that does not include an explicit requirement to provide services is a non-vesting condition.

Reload feature

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

Share-based payment arrangement

An agreement between an entity and another party (including an employee) to enter into a share-based payment transaction, which 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 its other equity instruments, or to receive equity instruments of the entity, if the specified

vesting conditions, if any, are met. This also applies to transfers of equity instruments of the entity's parent, or equity instruments of another entity in the same group, to parties that have supplied goods or services to the entity.

Share-based payment transaction

A transaction in which an entity receives goods or services as consideration for equity instruments of the entity (including shares or share options) or acquires goods or services for amounts that are based on the price of the entity's shares or other equity instruments of the entity.

Share option

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

Vest

The counterparty becomes entitled under a share-based payment arrangement, to receive cash, other assets, or equity instruments of an entity. Entitlement is no longer conditional on the satisfaction of any vesting conditions.

Vesting conditions

The conditions that determine whether an entity receives the services that entitle the counterparty to receive cash, other assets or equity instruments of the entity under a share-based payment arrangement. Vesting conditions are either service conditions or performance conditions. Service conditions require the counterparty to complete a specified period of service. Performance conditions require the counterparty to complete a specified period of service and specified performance targets to be met. A performance condition might include a market condition.

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