

CONTENTS

from paragraph

GUIDANCE ON IMPLEMENTING IFRS 2 SHARE-BASED PAYMENT

| | |
|---|--------------|
| DEFINITION OF GRANT DATE | IG1 |
| DEFINITION OF VESTING CONDITIONS | IG4A |
| TRANSACTIONS WITH PARTIES OTHER THAN EMPLOYEES | IG5 |
| Transactions in which the entity cannot identify specifically some or all of the goods or services received | IG5A |
| Measurement date for transactions with parties other than employees | IG6 |
| TRANSITIONAL ARRANGEMENTS | IG8 |
| EQUITY-SETTLED SHARE-BASED PAYMENT TRANSACTIONS | IG9 |
| CASH-SETTLED SHARE-BASED PAYMENT TRANSACTIONS | IG18 |
| SHARE-BASED PAYMENT TRANSACTIONS WITH A NET SETTLEMENT FEATURE FOR WITHHOLDING TAX OBLIGATIONS | IG19A |
| ACCOUNTING FOR A MODIFICATION OF A SHARE-BASED PAYMENT TRANSACTION THAT CHANGES ITS CLASSIFICATION FROM CASH-SETTLED TO EQUITY-SETTLED | IG19B |
| SHARE-BASED PAYMENT ARRANGEMENTS WITH CASH ALTERNATIVES | IG20 |
| SHARE-BASED PAYMENT TRANSACTIONS AMONG GROUP ENTITIES | IG22A |
| ILLUSTRATIVE DISCLOSURES | IG23 |
| SUMMARY OF CONDITIONS FOR A COUNTERPARTY TO RECEIVE AN EQUITY INSTRUMENT GRANTED AND OF ACCOUNTING TREATMENTS | IG24 |
| TABLE OF CONCORDANCE | |

Guidance on implementing IFRS 2 *Share-based Payment*

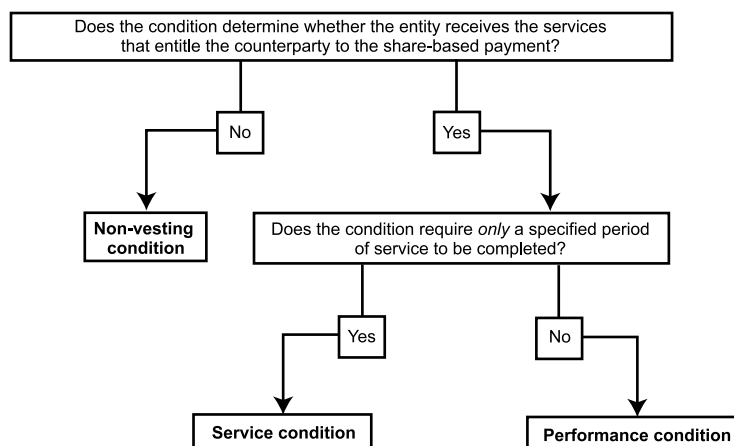
This guidance accompanies, but is not part of, IFRS 2.

Definition of grant date

- IG1 IFRS 2 defines grant date as the date at which the entity and the employee (or other party providing similar services) 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.
- IG2 As noted above, grant date is when both parties agree to a share-based payment arrangement. The word 'agree' is used in its usual sense, which means that there must be both an offer and acceptance of that offer. Hence, the date at which one party makes an offer to another party is not grant date. The date of grant is when that other party accepts the offer. In some instances, the counterparty explicitly agrees to the arrangement, eg by signing a contract. In other instances, agreement might be implicit, eg for many share-based payment arrangements with employees, the employees' agreement is evidenced by their commencing to render services.
- IG3 Furthermore, for both parties to have agreed to the share-based payment arrangement, both parties must have a shared understanding of the terms and conditions of the arrangement. Therefore, if some of the terms and conditions of the arrangement are agreed on one date, with the remainder of the terms and conditions agreed on a later date, then grant date is on that later date, when all of the terms and conditions have been agreed. For example, if an entity agrees to issue share options to an employee, but the exercise price of the options will be set by a compensation committee that meets in three months' time, grant date is when the exercise price is set by the compensation committee.
- IG4 In some cases, grant date might occur after the employees to whom the equity instruments were granted have begun rendering services. For example, if a grant of equity instruments is subject to shareholder approval, grant date might occur some months after the employees have begun rendering services in respect of that grant. The IFRS requires the entity to recognise the services when received. In this situation, the entity should estimate the grant date fair value of the equity instruments (eg by estimating the fair value of the equity instruments at the end of the reporting period), for the purposes of recognising the services received during the period between service commencement date and grant date. Once the date of grant has been established, the entity should revise the earlier estimate so that the amounts recognised for services received in respect of the grant are ultimately based on the grant date fair value of the equity instruments.

Definition of vesting conditions

IG4A IFRS 2 defines vesting conditions as the conditions that determine whether the 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. The following flowchart illustrates the evaluation of whether a condition is a service or performance condition or a non-vesting condition.



Transactions with parties other than employees

IG5 For transactions with parties other than employees (and others providing similar services) that are measured by reference to the fair value of the equity instruments granted, paragraph 13 of IFRS 2 includes a rebuttable presumption that the fair value of the goods or services received can be estimated reliably. In these situations, paragraph 13 of IFRS 2 requires the entity to measure that fair value at the date the entity obtains the goods or the counterparty renders service.

Transaction in which the entity cannot identify specifically some or all of the goods or services received

IG5A In some cases, however, it might be difficult to demonstrate that goods or services have been (or will be) received. For example, an entity may grant shares to a charitable organisation for nil consideration. It is usually not possible to identify the specific goods or services received in return for such a transaction. A similar situation might arise in transactions with other parties.

IG5B Paragraph 11 of IFRS 2 requires transactions in which share-based payments are made to employees to be measured by reference to the fair value of the share-based payments at grant date.¹ Hence, the entity is not required to measure directly the fair value of the employee services received.

¹ In IFRS 2, all references to employees include others providing similar services.

- IG5C It should be noted that the phrase ‘the fair value of the share-based payment’ refers to the fair value of the particular share-based payment concerned. For example, an entity might be required by government legislation to issue some portion of its shares to nationals of a particular country that may be transferred only to other nationals of that country. Such a transfer restriction may affect the fair value of the shares concerned, and therefore those shares may have a fair value that is less than the fair value of otherwise identical shares that do not carry such restrictions. In this situation, the phrase ‘the fair value of the share-based payment’ would refer to the fair value of the restricted shares, not the fair value of other, unrestricted shares.
- IG5D Paragraph 13A of IFRS 2 specifies how such transactions should be measured. The following example illustrates how the entity should apply the requirements of the IFRS to a transaction in which the entity cannot identify specifically some or all of the goods or services received.

| IG Example 1 |
|---|
| <p><i>Share-based payment transaction in which the entity cannot identify specifically some or all of the goods or services received</i></p> <p>Background</p> <p>An entity granted shares with a total fair value of CU100,000^(a) to parties other than employees who are from a particular section of the community (historically disadvantaged individuals), as a means of enhancing its image as a good corporate citizen. The economic benefits derived from enhancing its corporate image could take a variety of forms, such as increasing its customer base, attracting or retaining employees, or improving or maintaining its ability to tender successfully for business contracts.</p> <p>The entity cannot identify the specific consideration received. For example, no cash was received and no service conditions were imposed. Therefore, the identifiable consideration (nil) is less than the fair value of the equity instruments granted (CU100,000).</p> <p>Application of requirements</p> <p>Although the entity cannot identify the specific goods or services received, the circumstances indicate that goods or services have been (or will be) received, and therefore IFRS 2 applies.</p> <p>In this situation, because the entity cannot identify the specific goods or services received, the rebuttable presumption in paragraph 13 of IFRS 2, that the fair value of the goods or services received can be estimated reliably, does not apply. The entity should instead measure the goods or services received by reference to the fair value of the equity instruments granted.</p> |
| <p>(a) In this example, and in all other examples in this guidance, monetary amounts are denominated in ‘currency units (CU)’.</p> |

Measurement date for transactions with parties other than employees

- IG6 If the goods or services are received on more than one date, the entity should measure the fair value of the equity instruments granted on each date when goods or services are received. The entity should apply that fair value when measuring the goods or services received on that date.
- IG7 However, an approximation could be used in some cases. For example, if an entity received services continuously during a three-month period, and its share price did not change significantly during that period, the entity could use the average share price during the three-month period when estimating the fair value of the equity instruments granted.

Transitional arrangements

- IG8 In paragraph 54 of IFRS 2, the entity is encouraged, but not required, to apply the requirements of the IFRS to other grants of equity instruments (ie grants other than those specified in paragraph 53 of the IFRS), if the entity has disclosed publicly the fair value of those equity instruments, measured at the measurement date. For example, such equity instruments include equity instruments for which the entity has disclosed in the notes to its financial statements the information required in the US by SFAS 123 *Accounting for Stock-based Compensation*.

Equity-settled share-based payment transactions

- IG9 For equity-settled transactions measured by reference to the fair value of the equity instruments granted, paragraph 19 of IFRS 2 states that vesting conditions, other than market conditions,² are not taken into account when estimating the fair value of the shares or share options at the measurement date (ie grant date, for transactions with employees and others providing similar services). Instead, vesting conditions are taken into account by adjusting the number of equity instruments included in the measurement of the transaction amount so that, ultimately, the amount recognised for goods or services received as consideration for the equity instruments granted is based on the number of equity instruments that eventually vest. Hence, on a cumulative basis, no amount is recognised for goods or services received if the equity instruments granted do not vest because of failure to satisfy a vesting condition, eg the counterparty fails to complete a specified service period, or a performance condition is not satisfied. This accounting method is known as the modified grant date method, because the number of equity instruments included in the determination of the transaction amount is adjusted to reflect the outcome of the vesting conditions, but no adjustment is made to the fair value of those equity instruments. That fair value is estimated at grant date (for transactions with employees and others providing similar services) and not subsequently revised. Hence, neither increases nor decreases in the fair value of the equity instruments after grant date are taken into account when

² In the remainder of this paragraph, the discussion of vesting conditions excludes market conditions, which are subject to the requirements of paragraph 21 of IFRS 2.

determining the transaction amount (other than in the context of measuring the incremental fair value transferred if a grant of equity instruments is subsequently modified).

- IG10 To apply these requirements, paragraph 20 of IFRS 2 requires the entity to recognise the goods or services received during the vesting period based on the best available estimate of the number of equity instruments expected to vest and to revise that estimate, if necessary, if subsequent information indicates that the number of equity instruments expected to vest differs from previous estimates. On vesting date, the entity revises the estimate to equal the number of equity instruments that ultimately vested (subject to the requirements of paragraph 21 concerning market conditions).
- IG11 In the examples below, the share options granted all vest at the same time, at the end of a specified period. In some situations, share options or other equity instruments granted might vest in instalments over the vesting period. For example, suppose an employee is granted 100 share options, which will vest in instalments of 25 share options at the end of each year over the next four years. To apply the requirements of the IFRS, the entity should treat each instalment as a separate share option grant, because each instalment has a different vesting period, and hence the fair value of each instalment will differ (because the length of the vesting period affects, for example, the likely timing of cash flows arising from the exercise of the options).

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| IG Example 1A |
| Background |
| An entity grants 100 share 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 share option is CU15. |
| 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 share options. |

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| IG Example 1A | | | |
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| Application of requirements | | | |
| <u>Scenario 1</u> | | | |
| If everything turns out exactly as expected, the entity recognises the following amounts during the vesting period, for services received as consideration for the share options. | | | |
| Year | Calculation | Remuneration expense for period CU | Cumulative remuneration expense CU |
| 1 | 50,000 options × 80% × CU15 × $\frac{1}{3}$ years | 200,000 | 200,000 |
| 2 | (50,000 options × 80% × CU15 × $\frac{2}{3}$ years) – CU200,000 | 200,000 | 400,000 |
| 3 | (50,000 options × 80% × CU15 × $\frac{3}{3}$ years) – CU400,000 | 200,000 | 600,000 |
| <u>Scenario 2</u> | | | |
| During year 1, 20 employees leave. The entity revises its estimate of total employee departures over the three-year period from 20 per cent (100 employees) to 15 per cent (75 employees). During year 2, a further 22 employees leave. The entity revises its estimate of total employee departures over the three-year period from 15 per cent to 12 per cent (60 employees). During year 3, a further 15 employees leave. Hence, a total of 57 employees forfeited their rights to the share options during the three-year period, and a total of 44,300 share options (443 employees × 100 options per employee) vested at the end of year 3. | | | |
| Year | Calculation | Remuneration expense for period CU | Cumulative remuneration expense CU |
| 1 | 50,000 options × 85% × CU15 × $\frac{1}{3}$ years | 212,500 | 212,500 |
| 2 | (50,000 options × 88% × CU15 × $\frac{2}{3}$ years) – CU212,500 | 227,500 | 440,000 |
| 3 | (44,300 options × CU15) – CU440,000 | 224,500 | 664,500 |

IG12

In Example 1A, the share options were granted conditionally upon the employees' completing a specified service period. In some cases, a share option or share grant might also be conditional upon the achievement of a specified performance target. Examples 2, 3 and 4 illustrate the application of the IFRS to share option or share grants with performance conditions (other than market conditions, which are discussed in paragraph IG13 and illustrated

in Examples 5 and 6). In Example 2, the length of the vesting period varies, depending on when the performance condition is satisfied. Paragraph 15 of the IFRS requires the entity to estimate the length of the expected vesting period, based on the most likely outcome of the performance condition, and to revise that estimate, if necessary, if subsequent information indicates that the length of the vesting period is likely to differ from previous estimates.

IG Example 2

Grant with a performance condition, in which the length of the vesting period varies

Background

At the beginning of year 1, the entity grants 100 shares each to 500 employees, conditional upon the employees' remaining in the entity's employ during the vesting period. The shares will vest at the end of year 1 if the entity's earnings increase by more than 18 per cent; at the end of year 2 if the entity's earnings increase by more than an average of 13 per cent per year over the two-year period; and at the end of year 3 if the entity's earnings increase by more than an average of 10 per cent per year over the three-year period. The shares have a fair value of CU30 per share at the start of year 1, which equals the share price at grant date. No dividends are expected to be paid over the three-year period.

By the end of year 1, the entity's earnings have increased by 14 per cent, and 30 employees have left. The entity expects that earnings will continue to increase at a similar rate in year 2, and therefore expects that the shares will vest at the end of year 2. The entity expects, on the basis of a weighted average probability, that a further 30 employees will leave during year 2, and therefore expects that 440 employees will vest in 100 shares each at the end of year 2.

By the end of year 2, the entity's earnings have increased by only 10 per cent and therefore the shares do not vest at the end of year 2. 28 employees have left during the year. The entity expects that a further 25 employees will leave during year 3, and that the entity's earnings will increase by at least 6 per cent, thereby achieving the average of 10 per cent per year.

By the end of year 3, 23 employees have left and the entity's earnings had increased by 8 per cent, resulting in an average increase of 10.67 per cent per year. Therefore, 419 employees received 100 shares at the end of year 3.

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| IG Example 2 | | | |
|------------------------------------|---|---------------------------------------|---------------------------------------|
| Application of requirements | | | |
| Year | Calculation | Remuneration expense for period CU | Cumulative remuneration expense CU |
| 1 | 440 employees × 100 shares × CU30 × $\frac{1}{2}$ | 660,000 | 660,000 |
| 2 | (417 employees × 100 shares × CU30 × $\frac{2}{3}$) – CU660,000 | 174,000 | 834,000 |
| 3 | (419 employees × 100 shares × CU30 × $\frac{3}{3}$) – CU834,000 | 423,000 | 1,257,000 |

| IG Example 3 | |
|--|--|
| <i>Grant with a performance condition, in which the number of equity instruments varies</i> | |
| Background | |
| <p>At the beginning of year 1, Entity A grants share options to each of its 100 employees working in the sales department. The share options will vest at the end of year 3, provided that the employees remain in the entity's employ, and provided that the volume of sales of a particular product increases by at least an average of 5 per cent per year. If the volume of sales of the product increases by an average of between 5 per cent and 10 per cent per year, each employee will receive 100 share options. If the volume of sales increases by an average of between 10 per cent and 15 per cent each year, each employee will receive 200 share options. If the volume of sales increases by an average of 15 per cent or more, each employee will receive 300 share options.</p> <p>On grant date, Entity A estimates that the share options have a fair value of CU20 per option. Entity A also estimates that the volume of sales of the product will increase by an average of between 10 per cent and 15 per cent per year, and therefore expects that, for each employee who remains in service until the end of year 3, 200 share options will vest. The entity also estimates, on the basis of a weighted average probability, that 20 per cent of employees will leave before the end of year 3.</p> | |

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| IG Example 3 | | | |
|---|--|---------------------------------------|---------------------------------------|
| <p>By the end of year 1, seven employees have left and the entity still expects that a total of 20 employees will leave by the end of year 3. Hence, the entity expects that 80 employees will remain in service for the three-year period. Product sales have increased by 12 per cent and the entity expects this rate of increase to continue over the next 2 years.</p> | | | |
| <p>By the end of year 2, a further five employees have left, bringing the total to 12 to date. The entity now expects only three more employees will leave during year 3, and therefore expects a total of 15 employees will have left during the three-year period, and hence 85 employees are expected to remain. Product sales have increased by 18 per cent, resulting in an average of 15 per cent over the two years to date. The entity now expects that sales will average 15 per cent or more over the three-year period, and hence expects each sales employee to receive 300 share options at the end of year 3.</p> | | | |
| <p>By the end of year 3, a further two employees have left. Hence, 14 employees have left during the three-year period, and 86 employees remain. The entity's sales have increased by an average of 16 per cent over the three years. Therefore, each of the 86 employees receives 300 share options.</p> | | | |
| Application of requirements | | | |
| Year | Calculation | Remuneration expense for period CU | Cumulative remuneration expense CU |
| 1 | 80 employees × 200 options × CU20 × $\frac{1}{3}$ | 106,667 | 106,667 |
| 2 | (85 employees × 300 options × CU20 × $\frac{2}{3}$) – CU106,667 | 233,333 | 340,000 |
| 3 | (86 employees × 300 options × CU20 × $\frac{3}{3}$) – CU340,000 | 176,000 | 516,000 |

| IG Example 4 | | | |
|---|--|---------------------------------------|---------------------------------------|
| <i>Grant with a performance condition, in which the exercise price varies</i> | | | |
| Background | | | |
| At the beginning of year 1, an entity grants to a senior executive 10,000 share options, conditional upon the executive remaining in the entity's employ until the end of year 3. The exercise price is CU40. However, the exercise price drops to CU30 if the entity's earnings increase by at least an average of 10 per cent per year over the three-year period. | | | |
| On grant date, the entity estimates that the fair value of the share options, with an exercise price of CU30, is CU16 per option. If the exercise price is CU40, the entity estimates that the share options have a fair value of CU12 per option. | | | |
| During year 1, the entity's earnings increased by 12 per cent, and the entity expects that earnings will continue to increase at this rate over the next two years. The entity therefore expects that the earnings target will be achieved, and hence the share options will have an exercise price of CU30. | | | |
| During year 2, the entity's earnings increased by 13 per cent, and the entity continues to expect that the earnings target will be achieved. | | | |
| During year 3, the entity's earnings increased by only 3 per cent, and therefore the earnings target was not achieved. The executive completes three years' service, and therefore satisfies the service condition. Because the earnings target was not achieved, the 10,000 vested share options have an exercise price of CU40. | | | |
| Application of requirements | | | |
| Because the exercise price varies depending on the outcome of a performance condition that is not a market condition, the effect of that performance condition (ie the possibility that the exercise price might be CU40 and the possibility that the exercise price might be CU30) is not taken into account when estimating the fair value of the share options at grant date. Instead, the entity estimates the fair value of the share options at grant date under each scenario (ie exercise price of CU40 and exercise price of CU30) and ultimately revises the transaction amount to reflect the outcome of that performance condition, as illustrated below. | | | |
| Year | Calculation | Remuneration expense for period CU | Cumulative remuneration expense CU |
| 1 | 10,000 options × CU16 × $\frac{1}{3}$ | 53,333 | 53,333 |
| 2 | (10,000 options × CU16 × $\frac{2}{3}$) – CU53,333 | 53,334 | 106,667 |
| 3 | (10,000 options × CU12 × $\frac{3}{3}$) – CU106,667 | 13,333 | 120,000 |

IG13 Paragraph 21 of the IFRS requires market conditions, such as a target share price upon which vesting (or exercisability) is conditional, to be taken into account when estimating the fair value of the equity instruments granted. Therefore, for grants of equity instruments with market conditions, the entity recognises the goods or services received from a counterparty who satisfies all other vesting conditions (eg services received from an employee who remains in service for the specified period of service), irrespective of whether that market condition is satisfied. Example 5 illustrates these requirements.

IG Example 5

Grant with a market condition

Background

At the beginning of year 1, an entity grants to a senior executive 10,000 share options, conditional upon the executive remaining in the entity's employ until the end of year 3. However, the share options cannot be exercised unless the share price has increased from CU50 at the beginning of year 1 to above CU65 at the end of year 3. If the share price is above CU65 at the end of year 3, the share options can be exercised at any time during the next seven years, ie by the end of year 10.

The entity applies a binomial option pricing model, which takes into account the possibility that the share price will exceed CU65 at the end of year 3 (and hence the share options become exercisable) and the possibility that the share price will not exceed CU65 at the end of year 3 (and hence the options will be forfeited). It estimates the fair value of the share options with this market condition to be CU24 per option.

Application of requirements

Because paragraph 21 of the IFRS requires the entity to recognise the services received from a counterparty who satisfies all other vesting conditions (eg services received from an employee who remains in service for the specified service period), irrespective of whether that market condition is satisfied, it makes no difference whether the share price target is achieved. The possibility that the share price target might not be achieved has already been taken into account when estimating the fair value of the share options at grant date. Therefore, if the entity expects the executive to complete the three-year service period, and the executive does so, the entity recognises the following amounts in years 1, 2 and 3:

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| IG Example 5 | | | |
|---------------------|---|---------------------------------------|---------------------------------------|
| Year | Calculation | Remuneration expense for period CU | Cumulative remuneration expense CU |
| 1 | 10,000 options × CU24 × $\frac{1}{3}$ | 80,000 | 80,000 |
| 2 | (10,000 options × CU24 × $\frac{2}{3}$) – CU80,000 | 80,000 | 160,000 |
| 3 | (10,000 options × CU24) – CU160,000 | 80,000 | 240,000 |

As noted above, these amounts are recognised irrespective of the outcome of the market condition. However, if the executive left during year 2 (or year 3), the amount recognised during year 1 (and year 2) would be reversed in year 2 (or year 3). This is because the service condition, in contrast to the market condition, was not taken into account when estimating the fair value of the share options at grant date. Instead, the service condition is taken into account by adjusting the transaction amount to be based on the number of equity instruments that ultimately vest, in accordance with paragraphs 19 and 20 of the IFRS.

- IG14 In Example 5, the outcome of the market condition did not change the length of the vesting period. However, if the length of the vesting period varies depending on when a performance condition is satisfied, paragraph 15 of the IFRS requires the entity to presume that the services to be rendered by the employees as consideration for the equity instruments granted will be received in the future, over the expected vesting period. The entity is required to estimate the length of the expected vesting period at grant date, based on the most likely outcome of the performance condition. If the performance condition is a market condition, the estimate of the length of the expected vesting period must be consistent with the assumptions used in estimating the fair value of the share options granted, and is not subsequently revised. Example 6 illustrates these requirements.

| IG Example 6 |
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| <i>Grant with a market condition, in which the length of the vesting period varies</i> |
| Background |
| At the beginning of year 1, an entity grants 10,000 share options with a ten-year life to each of ten senior executives. The share options will vest and become exercisable immediately if and when the entity's share price increases from CU50 to CU70, provided that the executive remains in service until the share price target is achieved. |

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IG Example 6

The entity applies a binomial option pricing model, which takes into account the possibility that the share price target will be achieved during the ten-year life of the options, and the possibility that the target will not be achieved. The entity estimates that the fair value of the share options at grant date is CU25 per option. From the option pricing model, the entity determines that the mode of the distribution of possible vesting dates is five years. In other words, of all the possible outcomes, the most likely outcome of the market condition is that the share price target will be achieved at the end of year 5. Therefore, the entity estimates that the expected vesting period is five years. The entity also estimates that two executives will have left by the end of year 5, and therefore expects that 80,000 share options (10,000 share options × 8 executives) will vest at the end of year 5.

Throughout years 1–4, the entity continues to estimate that a total of two executives will leave by the end of year 5. However, in total three executives leave, one in each of years 3, 4 and 5. The share price target is achieved at the end of year 6. Another executive leaves during year 6, before the share price target is achieved.

Application of requirements

Paragraph 15 of the IFRS requires the entity to recognise the services received over the expected vesting period, as estimated at grant date, and also requires the entity not to revise that estimate. Therefore, the entity recognises the services received from the executives over years 1–5. Hence, the transaction amount is ultimately based on 70,000 share options (10,000 share options × 7 executives who remain in service at the end of year 5).

Although another executive left during year 6, no adjustment is made, because the executive had already completed the expected vesting period of five years. Therefore, the entity recognises the following amounts in years 1–5:

| Year | Calculation | Remuneration expense for period CU | Cumulative remuneration expense CU |
|------|---|---------------------------------------|---------------------------------------|
| 1 | 80,000 options × CU25 × $\frac{1}{5}$ | 400,000 | 400,000 |
| 2 | (80,000 options × CU25 × $\frac{2}{5}$) – CU400,000 | 400,000 | 800,000 |
| 3 | (80,000 options × CU25 × $\frac{3}{5}$) – CU800,000 | 400,000 | 1,200,000 |
| 4 | (80,000 options × CU25 × $\frac{4}{5}$) – CU1,200,000 | 400,000 | 1,600,000 |
| 5 | (70,000 options × CU25) – CU1,600,000 | 150,000 | 1,750,000 |

- IG15 Paragraphs 26–29 and B42–B44 of the IFRS set out requirements that apply if a share option is repriced (or the entity otherwise modifies the terms or conditions of a share-based payment arrangement). Examples 7–9 illustrate some of these requirements.

| IG Example 7 |
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| <p><i>Grant of share options that are subsequently repriced</i></p> <p>Background</p> <p>At the beginning of year 1, an entity grants 100 share options to each of its 500 employees. Each grant is conditional upon the employee remaining in service over the next three years. The entity estimates that the fair value of each option is CU15. On the basis of a weighted average probability, the entity estimates that 100 employees will leave during the three-year period and therefore forfeit their rights to the share options.</p> <p>Suppose that 40 employees leave during year 1. Also suppose that by the end of year 1, the entity's share price has dropped, and the entity reprices its share options, and that the repriced share options vest at the end of year 3. The entity estimates that a further 70 employees will leave during years 2 and 3, and hence the total expected employee departures over the three-year vesting period is 110 employees. During year 2, a further 35 employees leave, and the entity estimates that a further 30 employees will leave during year 3, to bring the total expected employee departures over the three-year vesting period to 105 employees. During year 3, a total of 28 employees leave, and hence a total of 103 employees ceased employment during the vesting period. For the remaining 397 employees, the share options vested at the end of year 3.</p> <p>The entity estimates that, at the date of repricing, the fair value of each of the original share options granted (ie before taking into account the repricing) is CU5 and that the fair value of each repriced share option is CU8.</p> |

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| IG Example 7 | | | |
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| Application of requirements | | | |
| <p>Paragraph 27 of the IFRS requires the entity to recognise the effects of modifications that increase the total fair value of the share-based payment arrangement or are otherwise beneficial to the employee. If the modification increases the fair value of the equity instruments granted (eg by reducing the exercise price), measured immediately before and after the modification, paragraph B43(a) of Appendix B requires the entity to include the incremental fair value granted (ie the difference between the fair value of the modified equity instrument and that of the original equity instrument, both estimated as at the date of the modification) in the measurement of the amount recognised for services received as consideration for the equity instruments granted. If the modification occurs during the vesting period, the incremental fair value granted is included in the measurement of the amount recognised for services received over the period from the modification date until the date when the modified equity instruments vest, in addition to the amount based on the grant date fair value of the original equity instruments, which is recognised over the remainder of the original vesting period.</p> <p>The incremental value is CU3 per share option (CU8 – CU5). This amount is recognised over the remaining two years of the vesting period, along with remuneration expense based on the original option value of CU15.</p> <p>The amounts recognised in years 1–3 are as follows:</p> | | | |
| Year | Calculation | Remuneration expense for period CU | Cumulative remuneration expense CU |
| 1 | $(500 - 110) \text{ employees} \times 100 \text{ options} \times \text{CU}15 \times \frac{1}{3}$ | 195,000 | 195,000 |
| 2 | $(500 - 105) \text{ employees} \times 100 \text{ options} \times (\text{CU}15 \times \frac{2}{3} + \text{CU}3 \times \frac{1}{2}) - \text{CU}195,000$ | 259,250 | 454,250 |
| 3 | $(500 - 103) \text{ employees} \times 100 \text{ options} \times (\text{CU}15 + \text{CU}3) - \text{CU}454,250$ | 260,350 | 714,600 |

IG Example 8

Grant of share options with a vesting condition that is subsequently modified

Background

At the beginning of year 1, the entity grants 1,000 share options to each member of its sales team, conditional upon the employee remaining in the entity's employ for three years, and the team selling more than 50,000 units of a particular product over the three-year period. The fair value of the share options is CU15 per option at the date of grant.

During year 2, the entity increases the sales target to 100,000 units. By the end of year 3, the entity has sold 55,000 units, and the share options are forfeited. Twelve members of the sales team have remained in service for the three-year period.

Application of requirements

Paragraph 20 of the IFRS requires, for a performance condition that is not a market condition, the entity to recognise the services received during the vesting period based on the best available estimate of the number of equity instruments expected to vest and to revise that estimate, if necessary, if subsequent information indicates that the number of equity instruments expected to vest differs from previous estimates. On vesting date, the entity revises the estimate to equal the number of equity instruments that ultimately vested. However, paragraph 27 of the IFRS requires, irrespective of any modifications to the terms and conditions on which the equity instruments were granted, or a cancellation or settlement of that grant of equity instruments, the entity to recognise, as a minimum, the services received, measured at the grant date fair value of the equity instruments granted, unless those equity instruments do not vest because of failure to satisfy a vesting condition (other than a market condition) that was specified at grant date. Furthermore, paragraph B44(c) of Appendix B specifies that, if the entity modifies the vesting conditions in a manner that is not beneficial to the employee, the entity does not take the modified vesting conditions into account when applying the requirements of paragraphs 19–21 of the IFRS.

Therefore, because the modification to the performance condition made it less likely that the share options will vest, which was not beneficial to the employee, the entity takes no account of the modified performance condition when recognising the services received. Instead, it continues to recognise the services received over the three-year period based on the original vesting conditions. Hence, the entity ultimately recognises cumulative remuneration expense of CU180,000 over the three-year period (12 employees × 1,000 options × CU15).

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IG Example 8

The same result would have occurred if, instead of modifying the performance target, the entity had increased the number of years of service required for the share options to vest from three years to ten years. Because such a modification would make it less likely that the options will vest, which would not be beneficial to the employees, the entity would take no account of the modified service condition when recognising the services received. Instead, it would recognise the services received from the twelve employees who remained in service over the original three-year vesting period.

IG Example 9

Grant of shares, with a cash alternative subsequently added

Background

At the beginning of year 1, the entity grants 10,000 shares with a fair value of CU33 per share to a senior executive, conditional upon the completion of three years' service. By the end of year 2, the share price has dropped to CU25 per share. At that date, the entity adds a cash alternative to the grant, whereby the executive can choose whether to receive 10,000 shares or cash equal to the value of 10,000 shares on vesting date. The share price is CU22 on vesting date.

Application of requirements

Paragraph 27 of the IFRS requires, irrespective of any modifications to the terms and conditions on which the equity instruments were granted, or a cancellation or settlement of that grant of equity instruments, the entity to recognise, as a minimum, the services received measured at the grant date fair value of the equity instruments granted, unless those equity instruments do not vest because of failure to satisfy a vesting condition (other than a market condition) that was specified at grant date. Therefore, the entity recognises the services received over the three-year period, based on the grant date fair value of the shares.

Furthermore, the addition of the cash alternative at the end of year 2 creates an obligation to settle in cash. In accordance with the requirements for cash-settled share-based payment transactions (paragraphs 30–33 of the IFRS), the entity recognises the liability to settle in cash at the modification date, based on the fair value of the shares at the modification date and the extent to which the specified services have been received. Furthermore, the entity remeasures the fair value of the liability at the end of each reporting period and at the date of settlement, with any changes in fair value recognised in profit or loss for the period. Therefore, the entity recognises the following amounts:

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| IG Example 9 | | | | |
|--|---|------------------------|---------------|----------------|
| Year | Calculation | Expense | Equity | Liability |
| | | CU | CU | CU |
| 1 | Remuneration expense for year: 10,000 shares × CU33 × $\frac{1}{3}$ | 110,000 | 110,000 | |
| 2 | Remuneration expense for year: (10,000 shares × CU33 × $\frac{2}{3}$) – CU110,000 | 110,000 | 110,000 | |
| | Reclassify equity to liabilities : 10,000 shares × CU25 × $\frac{2}{3}$ | | (166,667) | 166,667 |
| 3 | Remuneration expense for year: (10,000 shares × CU33 × $\frac{3}{3}$) – CU220,000 | 110,000 ^(a) | 26,667 | 83,333 |
| | Adjust liability to closing fair value: (CU166,667 + CU83,333) – (CU22 × 10,000 shares) | (30,000) | | (30,000) |
| | Total | 300,000 | 80,000 | 220,000 |
| (a) Allocated between liabilities and equity, to bring in the final third of the liability based on the fair value of the shares as at the date of the modification. | | | | |

IG15A If a share-based payment has a non-vesting condition that the counterparty can choose not to meet and the counterparty does not meet that non-vesting condition during the vesting period, paragraph 28A of the IFRS requires that event to be treated as a cancellation. Example 9A illustrates the accounting for this type of event.

| IG Example 9A |
|---|
| <i>Share-based payment with vesting and non-vesting conditions when the counterparty can choose whether the non-vesting condition is met</i> |
| Background |
| An entity grants an employee the opportunity to participate in a plan in which the employee obtains share options if he agrees to save 25 per cent of his monthly salary of CU400 for a three-year period. The monthly payments are made by deduction from the employee's salary. The employee may use the accumulated savings to exercise his options at the end of three years, or take a refund of his contributions at any point during the three-year period. The estimated annual expense for the share-based payment arrangement is CU120. |
| After 18 months, the employee stops paying contributions to the plan and takes a refund of contributions paid to date of CU1,800. |

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| IG Example 9A | | | | |
|--|--|----------------|----------------|--------------|
| Application of requirements | | | | |
| <p>There are three components to this plan: paid salary, salary deduction paid to the savings plan and share-based payment. The entity recognises an expense in respect of each component and a corresponding increase in liability or equity as appropriate. The requirement to pay contributions to the plan is a non-vesting condition, which the employee chooses not to meet in the second year. Therefore, in accordance with paragraphs 28(b) and 28A of the IFRS, the repayment of contributions is treated as an extinguishment of the liability and the cessation of contributions in year 2 is treated as a cancellation.</p> | | | | |
| YEAR 1 | Expense | Cash | Liability | Equity |
| | CU | CU | CU | CU |
| Paid salary | 3,600 (75% × 400 × 12) | (3,600) | | |
| Salary deduction paid to the savings plan | 1,200 (25% × 400 × 12) | | (1,200) | |
| Share-based payment | 120 | | | (120) |
| Total | 4,920 | (3,600) | (1,200) | (120) |
| YEAR 2 | | | | |
| Paid salary | 4,200 (75% × 400 × 6 + 100% × 400 × 6) | (4,200) | | |
| Salary deduction paid to the savings plan | 600 (25% × 400 × 6) | | (600) | |
| Refund of contributions to the employee | | (1,800) | 1,800 | |
| Share-based payment (acceleration of remaining expense) | 240 (120 × 3 – 120) | | | (240) |
| Total | 5,040 | (6,000) | 1,200 | (240) |

IG16 Paragraph 24 of the IFRS requires that, in rare cases only, in which the IFRS requires the entity to measure an equity-settled share-based payment transaction by reference to the fair value of the equity instruments granted, but the entity is unable to estimate reliably that fair value at the specified measurement date (eg grant date, for transactions with employees), the entity

shall instead measure the transaction using an intrinsic value measurement method. Paragraph 24 also contains requirements on how to apply this method. The following example illustrates these requirements.

| IG Example 10 | | |
|--|-------------------------|---|
| <i>Grant of share options that is accounted for by applying the intrinsic value method</i> | | |
| Background | | |
| At the beginning of year 1, an entity grants 1,000 share options to 50 employees. The share options will vest at the end of year 3, provided the employees remain in service until then. The share options have a life of 10 years. The exercise price is CU60 and the entity's share price is also CU60 at the date of grant. | | |
| At the date of grant, the entity concludes that it cannot estimate reliably the fair value of the share options granted. | | |
| At the end of year 1, three employees have ceased employment and the entity estimates that a further seven employees will leave during years 2 and 3. Hence, the entity estimates that 80 per cent of the share options will vest. | | |
| Two employees leave during year 2, and the entity revises its estimate of the number of share options that it expects will vest to 86 per cent. | | |
| Two employees leave during year 3. Hence, 43,000 share options vested at the end of year 3. | | |
| The entity's share price during years 1–10, and the number of share options exercised during years 4–10, are set out below. Share options that were exercised during a particular year were all exercised at the end of that year. | | |
| Year | Share price at year-end | Number of share options exercised at year-end |
| 1 | 63 | 0 |
| 2 | 65 | 0 |
| 3 | 75 | 0 |
| 4 | 88 | 6,000 |
| 5 | 100 | 8,000 |
| 6 | 90 | 5,000 |
| 7 | 96 | 9,000 |
| 8 | 105 | 8,000 |
| 9 | 108 | 5,000 |
| 10 | 115 | 2,000 |

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| IG Example 10 | | | |
|---|---|--------------------------|--------------------------|
| Application of requirements | | | |
| In accordance with paragraph 24 of the IFRS, the entity recognises the following amounts in years 1–10. | | | |
| Year | Calculation | Expense for period CU | Cumulative expense CU |
| 1 | 50,000 options × 80% × (CU63 – CU60) × $\frac{1}{3}$ years | 40,000 | 40,000 |
| 2 | 50,000 options × 86% × (CU65 – CU60) × $\frac{2}{3}$ years – CU40,000 | 103,333 | 143,333 |
| 3 | 43,000 options × (CU75 – CU60) – CU143,333 | 501,667 | 645,000 |
| 4 | 37,000 outstanding options × (CU88 – CU75) + 6,000 exercised options × (CU88 – CU75) | 559,000 | 1,204,000 |
| 5 | 29,000 outstanding options × (CU100 – CU88) + 8,000 exercised options × (CU100 – CU88) | 444,000 | 1,648,000 |
| 6 | 24,000 outstanding options × (CU90 – CU100) + 5,000 exercised options × (CU90 – CU100) | (290,000) | 1,358,000 |
| 7 | 15,000 outstanding options × (CU96 – CU90) + 9,000 exercised options × (CU96 – CU90) | 144,000 | 1,502,000 |
| 8 | 7,000 outstanding options × (CU105 – CU96) + 8,000 exercised options × (CU105 – CU96) | 135,000 | 1,637,000 |
| 9 | 2,000 outstanding options × (CU108 – CU105) + 5,000 exercised options × (CU108 – CU105) | 21,000 | 1,658,000 |
| 10 | 2,000 exercised options × (CU115 – CU108) | 14,000 | 1,672,000 |

IG17 There are many different types of employee share and share option plans. The following example illustrates the application of IFRS 2 to one particular type of plan—an employee share purchase plan. Typically, an employee share purchase plan provides employees with the opportunity to purchase the entity's shares at a discounted price. The terms and conditions under which employee share purchase plans operate differ from country to country. That is to say, not only are there many different types of employee share and share options plans, there are also many different types of employee share purchase

plans. Therefore, the following example illustrates the application of IFRS 2 to one specific employee share purchase plan.

| IG Example 11 |
|---|
| <p><i>Employee share purchase plan</i></p> <p>Background</p> <p>An entity offers all its 1,000 employees the opportunity to participate in an employee share purchase plan. The employees have two weeks to decide whether to accept the offer. Under the terms of the plan, the employees are entitled to purchase a maximum of 100 shares each. The purchase price will be 20 per cent less than the market price of the entity's shares at the date the offer is accepted, and the purchase price must be paid immediately upon acceptance of the offer. All shares purchased must be held in trust for the employees, and cannot be sold for five years. The employee is not permitted to withdraw from the plan during that period. For example, if the employee ceases employment during the five-year period, the shares must nevertheless remain in the plan until the end of the five-year period. Any dividends paid during the five-year period will be held in trust for the employees until the end of the five-year period.</p> <p>In total, 800 employees accept the offer and each employee purchases, on average, 80 shares, ie the employees purchase a total of 64,000 shares. The weighted-average market price of the shares at the purchase date is CU30 per share, and the weighted-average purchase price is CU24 per share.</p> <p>Application of requirements</p> <p>For transactions with employees, IFRS 2 requires the transaction amount to be measured by reference to the fair value of the equity instruments granted (IFRS 2, paragraph 11). To apply this requirement, it is necessary first to determine the type of equity instrument granted to the employees. Although the plan is described as an employee share purchase plan (ESPP), some ESPPs include option features and are therefore, in effect, share option plans. For example, an ESPP might include a 'look-back feature', whereby the employee is able to purchase shares at a discount, and choose whether the discount is applied to the entity's share price at the date of grant or its share price at the date of purchase. Or an ESPP might specify the purchase price, and then allow the employees a significant period of time to decide whether to participate in the plan. Another example of an option feature is an ESPP that permits the participating employees to cancel their participation before or at the end of a specified period and obtain a refund of amounts previously paid into the plan.</p> |

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IG Example 11

However, in this example, the plan includes no option features. The discount is applied to the share price at the purchase date, and the employees are not permitted to withdraw from the plan.

Another factor to consider is the effect of post-vesting transfer restrictions, if any. Paragraph B3 of IFRS 2 states that, if shares are subject to restrictions on transfer after vesting date, that factor should be taken into account when estimating the fair value of those shares, but only to the extent that the post-vesting restrictions affect the price that a knowledgeable, willing market participant would pay for that share. For example, if the shares are actively traded in a deep and liquid market, post-vesting transfer restrictions may have little, if any, effect on the price that a knowledgeable, willing market participant would pay for those shares.

In this example, the shares are vested when purchased, but cannot be sold for five years after the date of purchase. Therefore, the entity should consider the valuation effect of the five-year post-vesting transfer restriction. This entails using a valuation technique to estimate what the price of the restricted share would have been on the purchase date in an arm's length transaction between knowledgeable, willing parties. Suppose that, in this example, the entity estimates that the fair value of each restricted share is CU28. In this case, the fair value of the equity instruments granted is CU4 per share (being the fair value of the restricted share of CU28 less the purchase price of CU24). Because 64,000 shares were purchased, the total fair value of the equity instruments granted is CU256,000.

In this example, there is no vesting period. Therefore, in accordance with paragraph 14 of IFRS 2, the entity should recognise an expense of CU256,000 immediately.

However, in some cases, the expense relating to an ESPP might not be material. IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* states that the accounting policies in IFRSs need not be applied when the effect of applying them is immaterial (IAS 8, paragraph 8). IAS 1 *Presentation of Financial Statements* states that information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity. Materiality depends on the nature or magnitude of information, or both. An entity assesses whether information, either individually or in combination with other information, is material in the context of its financial statements taken as a whole (IAS 1, paragraph 7). Therefore, in this example, the entity should consider whether the expense of CU256,000 is material.

Cash-settled share-based payment transactions

- IG18 Paragraphs 30–33 of the 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. 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.
- IG19 For example, an entity might grant share appreciation rights to employees as part of their remuneration 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. If the share appreciation rights do not vest until the employees have completed a specified period of service, the entity recognises the services received, and a liability to pay for them, as the employees render service during that period. The liability is measured, initially and at the end of each reporting period until settled, at the fair value of the share appreciation rights in accordance with paragraphs 30–33D of IFRS 2. Changes in fair value are recognised in profit or loss. Therefore, if the amount recognised for the services received was included in the carrying amount of an asset recognised in the entity’s statement of financial position (for example, inventory), the carrying amount of that asset is not adjusted for the effects of the liability remeasurement. Example 12 illustrates these requirements for a cash-settled share-based payment transaction that is subject to a service condition. Example 12A illustrates these requirements for a cash-settled share-based payment transaction that is subject to a performance condition.

IG Example 12

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.

During year 1, 35 employees leave. The entity estimates that a further 60 will leave during years 2 and 3. During year 2, 40 employees leave and the entity estimates that a further 25 will leave during year 3. During year 3, 22 employees leave. 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 113 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. 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.

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| IG Example 12 | | | |
|------------------------------------|---|----------------------|-----------------|
| Year | | Fair value | Intrinsic value |
| 1 | | CU14.40 | |
| 2 | | CU15.50 | |
| 3 | | CU18.20 | CU15.00 |
| 4 | | CU21.40 | CU20.00 |
| 5 | | | CU25.00 |
| Application of requirements | | | |
| Year | Calculation | Expense | Liability |
| | | CU | CU |
| 1 | (500 – 95) employees × 100 SARs × CU14.40 × $\frac{1}{3}$ | 194,400 | 194,400 |
| 2 | (500 – 100) employees × 100 SARs × CU15.50 × $\frac{2}{3}$ – CU194,400 | 218,933 | 413,333 |
| 3 | (500 – 97 – 150) employees × 100 SARs × CU18.20 – CU413,333 + 150 employees × 100 SARs × CU15.00 | 47,127 225,000 | 460,460 |
| | Total | 272,127 | |
| 4 | (253 – 140) employees × 100 SARs × CU21.40 – CU460,460 + 140 employees × 100 SARs × CU20.00 | (218,640) 280,000 | 241,820 |
| | Total | 61,360 | |
| 5 | CU0 – CU241,820 + 113 employees × 100 SARs × CU25.00 | (241,820) 282,500 | 0 |
| | Total | 40,680 | |
| | Total | 787,500 | |

IG Example 12A**Background**

An entity grants 100 cash-settled share appreciation rights (SARs) to each of its 500 employees on the condition that the employees remain in its employ for the next three years and the entity reaches a revenue target (CU1 billion in sales) by the end of Year 3. The entity expects all employees to remain in its employ.

For simplicity, this example assumes that none of the employees' compensation qualifies for capitalisation as part of the cost of an asset.

At the end of Year 1, the entity expects that the revenue target will not be achieved by the end of Year 3. During Year 2, the entity's revenue increased significantly and it expects that it will continue to grow. Consequently, at the end of Year 2, the entity expects that the revenue target will be achieved by the end of Year 3.

At the end of Year 3, the revenue target is achieved and 150 employees exercise their SARs. Another 150 employees exercise their SARs at the end of Year 4 and the remaining 200 employees exercise their SARs at the end of Year 5.

Using an option pricing model, the entity estimates the fair value of the SARs, ignoring the revenue target performance condition and the employment-service condition, at the end of each year until all of the cash-settled share-based payments are settled. At the end of Year 3, all of the SARs vest. The following table shows the estimated fair value of the SARs at the end of each year and the intrinsic values of the SARs at the date of exercise (which equals the cash paid out).

| Year | Fair value of one SAR | Intrinsic value of one SAR |
|------|--------------------------|----------------------------------|
| 1 | CU14.40 | – |
| 2 | CU15.50 | – |
| 3 | CU18.20 | CU15.00 |
| 4 | CU21.40 | CU20.00 |
| 5 | CU25.00 | CU25.00 |

Application of requirements

| | Number of employees expected to satisfy the service condition | Best estimate of whether the revenue target will be met |
|--------|--|--|
| Year 1 | 500 | No |
| Year 2 | 500 | Yes |
| Year 3 | 500 | Yes |

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| IG Example 12A | | | | | |
|-----------------------|---|---------|-----------|-----------|---------|
| Year | Calculation | Expense | | Liability | |
| | | CU | | CU | |
| 1 | SARs are not expected to vest: no expense is recognised | – | | – | |
| 2 | SARs are expected to vest: 500 employees × 100 SARs × CU15.50 × ² / ₃ | 516,667 | | 516,667 | |
| 3 | (500 – 150) employees × 100 SARs × CU18.20 × ³ / ₃ – CU516,667 | | 120,333 | | 637,000 |
| | + 150 employees × 100 SARs × CU15.00 | | 225,000 | | |
| | Total | | 345,333 | | |
| 4 | (350 – 150) employees × 100 SARs × CU21.40 – CU637,000 | | (209,000) | | 428,000 |
| | + 150 employees × 100 SARs × CU20.00 | | 300,000 | | |
| | Total | | 91,000 | | |
| 5 | (200 – 200) employees × 100 SARs × CU25.00 – CU428,000 | | (428,000) | | – |
| | + 200 employees × 100 SARs × CU25.00 | | 500,000 | | |
| | Total | | 72,000 | | |
| | Total | | 1,025,000 | | |

Share-based payment transactions with a net settlement feature for withholding tax obligations

IG19A Paragraphs 33E and 33F require an entity to classify an arrangement in its entirety as an equity-settled share-based payment transaction if it would have been so classified in the absence of a net settlement feature that obliges the entity to withhold an amount for an employee's tax obligation associated with a share-based payment. The entity transfers that amount, normally in cash, to the tax authority on the employee's behalf. Example 12B illustrates these requirements.

IG Example 12B**Background**

The tax law in jurisdiction X requires entities to withhold an amount for an employee's tax obligation associated with a share-based payment and transfer that amount in cash to the tax authority on the employee's behalf.

On 1 January 20X1 an entity in jurisdiction X grants an award of 100 shares to an employee; that award is conditional upon the completion of four years' service. The entity expects that the employee will complete the service period. For simplicity, this example assumes that none of the employee's compensation qualifies for capitalisation as part of the cost of an asset.

The terms and conditions of the share-based payment arrangement require the entity to withhold shares from the settlement of the award to its employee in order to settle the employee's tax obligation (that is, the share-based payment arrangement has a 'net settlement feature'). Accordingly, the entity settles the transaction on a net basis by withholding the number of shares with a fair value equal to the monetary value of the employee's tax obligation and issuing the remaining shares to the employee on completion of the vesting period.

The employee's tax obligation associated with the award is calculated based on the fair value of the shares on the vesting date. The employee's applicable tax rate is 40 per cent.

At grant date, the fair value of each share is CU2. The fair value of each share at 31 December 20X4 is CU10.

The fair value of the shares on the vesting date is CU1,000 (100 shares × CU10 per share) and therefore the employee's tax obligation is CU400 (100 shares × CU10 × 40%). Accordingly, on the vesting date, the entity issues 60 shares to the employee and withholds 40 shares (CU400 = 40 shares × CU10 per share). The entity pays the fair value of the withheld shares in cash to the tax authority on the employee's behalf. In other words, it is as if the entity had issued all 100 vested shares to the employee, and at the same time, repurchased 40 shares at their fair value.

Application of requirements

| Year | Calculation | Dr. | Cr. | Cr. |
|------|---|---------|--------|-----------|
| | | Expense | Equity | Liability |
| | | CU | CU | CU |
| 1 | 100 shares × CU2 × $\frac{1}{4}$ | 50 | (50) | – |
| 2 | 100 shares × CU2 × $\frac{2}{4}$ – CU50 | 50 | (50) | – |
| 3 | 100 shares × CU2 × $\frac{3}{4}$ – (CU50 + CU50) | 50 | (50) | – |
| 4 | 100 shares × CU2 × $\frac{4}{4}$ – (CU50 + CU50 + CU50) | 50 | (50) | – |
| | Total | 200 | (200) | – |

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| IG Example 12B | |
|--|------------------|
| The journal entries recorded by the entity are as follows: | |
| <i>During the vesting period</i> | |
| Accumulated compensation expense recognised over the vesting period | |
| Dr Expense | 200 |
| | Cr Equity 200 |
| <i>Recognition of the tax liability^(a)</i> | |
| Dr Equity | 400 |
| | Cr Liability 400 |
| <i>Settlement of tax obligation</i> | |
| Cash paid to the tax authority on the employee's behalf at the date of settlement | |
| Dr Liability | 400 |
| | Cr Cash 400 |
| (a) The entity considers disclosing an estimate of the amount that it expects to transfer to the tax authority at the end of each reporting period. The entity makes such disclosure when it determines that this information is necessary to inform users about the future cash flow effects associated with the share-based payment. | |

Accounting for a modification of a share-based payment transaction that changes its classification from cash-settled to equity-settled

IG19B The following example illustrates the application of the requirements in paragraph B44A of IFRS 2 to a modification of the terms and conditions of a cash-settled share-based payment transaction that becomes an equity-settled share-based payment transaction.

| IG Example 12C |
|---|
| Background |
| On 1 January 20X1 an entity grants 100 share appreciation rights (SARs) that will be settled in cash to each of 100 employees on the condition that employees will remain employed for the next four years. |
| On 31 December 20X1 the entity estimates that the fair value of each SAR is CU10 and consequently, the total fair value of the cash-settled award is CU100,000. On 31 December 20X2 the estimated fair value of each SAR is CU12 and consequently, the total fair value of the cash-settled award is CU120,000. |

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| IG Example 12C |
|---|
| <p>On 31 December 20X2 the entity cancels the SARs and, in their place, grants 100 share options to each employee on the condition that each employee remains in its employ for the next two years. Therefore the original vesting period is not changed. On this date the fair value of each share option is CU13.20 and consequently, the total fair value of the new grant is CU132,000. All of the employees are expected to and ultimately do provide the required service.</p> <p>For simplicity, this example assumes that none of the employees' compensation qualifies for capitalisation as part of the cost of an asset.</p> <p>Application of requirements</p> <p>At the modification date (31 December 20X2), the entity applies paragraph B44A. Accordingly:</p> <ul style="list-style-type: none"> (a) from the date of the modification, the share options are measured by reference to their modification-date fair value and, at the modification date, the share options are recognised in equity to the extent to which the employees have rendered services; (b) the liability for the SARs is derecognised at the modification date; and (c) the difference between the carrying amount of the liability derecognised and the equity amount recognised at the modification date is recognised immediately in profit or loss. <p>At the modification date (31 December 20X2), the entity compares the fair value of the equity-settled replacement award for services provided through to the modification date ($CU132,000 \times \frac{2}{4} = CU66,000$) with the fair value of the cash-settled original award for those services ($CU120,000 \times \frac{2}{4} = CU60,000$). The difference (CU6,000) is recognised immediately in profit or loss at the date of the modification.</p> <p>The remainder of the equity-settled share-based payment (measured at its modification-date fair value) is recognised in profit or loss over the remaining two-year vesting period from the date of the modification.</p> |

continued...

...continued

| IG Example 12C | | | | | |
|-----------------------|--|-------------------------------|--------------------------------------|------------------------------|---------------------------------|
| Year | Calculation | Dr. Expense CU | Cumulative expense CU | Cr. Equity CU | Cr. Liability CU |
| 1 | 100 employees × 100 SARs × CU10 × $\frac{1}{4}$ | 25,000 | – | – | 25,000 |
| 2 | <i>Remeasurement before the modification</i> 100 employees × 100 SARs × CU12.00 × $\frac{2}{4}$ – 25,000 | 35,000 | 60,000 | – | 35,000 |
| | <i>Derecognition of the liability, recognition of the modifica- tion-date fair value amount in equity and recognition of the effect of settlement for CU6,000 (100 employees × 100 share options × CU13.20 × $\frac{2}{4}$) – (100 employees × 100 SARs × CU12.00 × $\frac{2}{4}$)</i> | 6,000 | 66,000 | 66,000 | (60,000) |
| 3 | 100 employees × 100 share options × CU13.20 × $\frac{3}{4}$ – CU66,000 | 33,000 | 99,000 | 33,000 | – |
| 4 | 100 employees × 100 share options × CU13.20 × $\frac{4}{4}$ – CU99,000 | 33,000 | 132,000 | 33,000 | – |
| | Total | | | 132,000 | – |

Share-based payment arrangements with cash alternatives

- IG20 Some employee share-based payment arrangements permit the employee to choose whether to receive cash or equity instruments. In this situation, a compound financial instrument has been granted, ie a financial instrument with debt and equity components. Paragraph 37 of the IFRS requires the entity to estimate the fair value of the compound financial instrument at grant date, by first measuring the fair value of the debt component, and then measuring the fair value of the equity component—taking into account that the employee must forfeit the right to receive cash to receive the equity instrument.
- IG21 Typically, share-based payment arrangements with cash alternatives are structured so that the fair value of one settlement alternative is the same as the other. For example, the employee might have the choice of receiving share options or cash share appreciation rights. In such cases, the fair value of the equity component will be zero, and hence the fair value of the compound

financial instrument will be the same as the fair value of the debt component. However, if the fair values of the settlement alternatives differ, usually the fair value of the equity component will be greater than zero, in which case the fair value of the compound financial instrument will be greater than the fair value of the debt component.

IG22 Paragraph 38 of the IFRS requires the entity to account separately for the services received in respect of each component of the compound financial instrument. For the debt component, the entity recognises the services received, and a liability to pay for those services, as the counterparty renders service, in accordance with the requirements applying to cash-settled share-based payment transactions. For the equity component (if any), the entity recognises the services received, and an increase in equity, as the counterparty renders service, in accordance with the requirements applying to equity-settled share-based payment transactions. Example 13 illustrates these requirements.

| IG Example 13 |
|---|
| <p>Background</p> <p>An entity grants to an employee the right to choose either 1,000 phantom shares, ie a right to a cash payment equal to the value of 1,000 shares, or 1,200 shares. The grant is conditional upon the completion of three years' service. If the employee chooses the share alternative, the shares must be held for three years after vesting date.</p> <p>At grant date, the entity's share price is CU50 per share. At the end of years 1, 2 and 3, the share price is CU52, CU55 and CU60 respectively. The entity does not expect to pay dividends in the next three years. After taking into account the effects of the post-vesting transfer restrictions, the entity estimates that the grant date fair value of the share alternative is CU48 per share.</p> <p>At the end of year 3, the employee chooses:</p> <p><u>Scenario 1</u>: The cash alternative</p> <p><u>Scenario 2</u>: The equity alternative</p> |

continued...

...continued

| IG Example 13 | | | | |
|---|--|---------------|---------------|-----------------|
| Application of requirements | | | | |
| The fair value of the equity alternative is CU57,600 (1,200 shares × CU48). The fair value of the cash alternative is CU50,000 (1,000 phantom shares × CU50). Therefore, the fair value of the equity component of the compound instrument is CU7,600 (CU57,600 – CU50,000). | | | | |
| The entity recognises the following amounts: | | | | |
| Year | | Expense CU | Equity CU | Liability CU |
| 1 | Liability component: (1,000 × CU52 × 1/3) | 17,333 | | 17,333 |
| | Equity component: (CU7,600 × 1/3) | 2,533 | 2,533 | |
| 2 | Liability component: (1,000 × CU55 × 2/3) – CU17,333 | 19,333 | | 19,333 |
| | Equity component: (CU7,600 × 1/3) | 2,533 | 2,533 | |
| 3 | Liability component: (1,000 × CU60) – CU36,666 | 23,334 | | 23,334 |
| | Equity component: (CU7,600 × 1/3) | 2,534 | 2,534 | |
| End Year | Scenario 1: cash of CU60,000 paid | | | |
| 3 | Scenario 1 totals | <u>67,600</u> | <u>7,600</u> | <u>0</u> |
| | Scenario 2: 1,200 shares issued | | 60,000 | (60,000) |
| | Scenario 2 totals | <u>67,600</u> | <u>67,600</u> | <u>0</u> |

Share-based payment transactions among group entities

IG22A Paragraphs 43A and 43B of IFRS 2 specify the accounting requirements for share-based payment transactions among group entities in the separate or individual financial statements of the entity receiving the goods or services. Example 14 illustrates the journal entries in the separate or individual financial statements for a group transaction in which a parent grants rights to its equity instruments to the employees of its subsidiary.

| IG Example 14 | | |
|--|-----------|-----------|
| <i>Share-based payment transactions in which a parent grants rights to its equity instruments to the employees of its subsidiary</i> | | |
| Background | | |
| A parent grants 200 share options to each of 100 employees of its subsidiary, conditional upon the completion of two years' service with the subsidiary. The fair value of the share options on grant date is CU30 each. At grant date, the subsidiary estimates that 80 per cent of the employees will complete the two-year service period. This estimate does not change during the vesting period. At the end of the vesting period, 81 employees complete the required two years of service. The parent does not require the subsidiary to pay for the shares needed to settle the grant of share options. | | |
| Application of requirements | | |
| As required by paragraph B53 of the IFRS, over the two-year vesting period, the subsidiary measures the services received from the employees in accordance with the requirements applicable to equity-settled share-based payment transactions. Thus, the subsidiary measures the services received from the employees on the basis of the fair value of the share options at grant date. An increase in equity is recognised as a contribution from the parent in the separate or individual financial statements of the subsidiary. The journal entries recorded by the subsidiary for each of the two years are as follows: | | |
| <i>Year 1</i> | | |
| Dr Remuneration expense (200 × 100 × CU30 × 0.8/2) | CU240,000 | |
| Cr Equity (Contribution from the parent) | | CU240,000 |
| <i>Year 2</i> | | |
| Dr Remuneration expense (200 × 100 × CU30 × 0.81 – 240,000) | CU246,000 | |
| Cr Equity (Contribution from the parent) | | CU246,000 |

Illustrative disclosures

IG23 The following example illustrates the disclosure requirements in paragraphs 44–52 of the IFRS.³

Extract from the Notes to the Financial Statements of Company Z for the year ended 31 December 20X5.

³ 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 47(c), 48 and 49 of the IFRS.

Share-based Payment

During the period ended 31 December 20X5, the Company had four share-based payment arrangements, which are described below.

| Type of arrangement | Senior management share option plan | General employee share option plan | Executive share plan | Senior management share appreciation cash plan |
|---------------------|---|------------------------------------|--|--|
| Date of grant | 1 January 20X4 | 1 January 20X5 | 1 January 20X5 | 1 July 20X5 |
| Number granted | 50,000 | 75,000 | 50,000 | 25,000 |
| Contractual life | 10 years | 10 years | N/A | 10 years |
| Vesting conditions | 1.5 years' service and achievement of a share price target, which was achieved. | Three years' service. | Three years' service and achievement of a target growth in earnings per share. | Three years' service and achievement of a target increase in market share. |

The estimated fair value of each share option granted in the general employee share option plan is CU23.60. This was calculated by applying a binomial option pricing model. The model inputs were the share price at grant date of CU50, exercise price of CU50, expected volatility of 30 per cent, no expected dividends, contractual life of ten years, and a risk-free interest rate of 5 per cent. To allow for the effects of early exercise, it was assumed that the employees would exercise the options after vesting date when the share price was twice the exercise price. Historical volatility was 40 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 estimated fair value of each share granted in the executive share plan is CU50.00, which is equal to the share price at the date of grant.

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

| | 20X4 | | 20X5 | |
|------------------------------|-------------------|---------------------------------|-------------------|---------------------------------|
| | Number of options | Weighted average exercise price | Number of options | Weighted average exercise price |
| Outstanding at start of year | 0 | – | 45,000 | CU40 |
| Granted | 50,000 | CU40 | 75,000 | CU50 |
| Forfeited | (5,000) | CU40 | (8,000) | CU46 |
| Exercised | 0 | – | (4,000) | CU40 |
| Outstanding at end of year | 45,000 | CU40 | 108,000 | CU46 |
| Exercisable at end of year | 0 | CU40 | 38,000 | CU40 |

IFRS 2 IG

The weighted average share price at the date of exercise for share options exercised during the period was CU52. The options outstanding at 31 December 20X5 had an exercise price of CU40 or CU50, and a weighted average remaining contractual life of 8.64 years.

| | 20X4 | 20X5 |
|---|---------|-----------|
| | CU | CU |
| Expense arising from share-based payment transactions | 495,000 | 1,105,867 |
| Expense arising from share and share option plans | 495,000 | 1,007,000 |
| Closing balance of liability for cash share appreciation plan | – | 98,867 |
| Expense arising from increase in fair value of liability for cash share appreciation plan | – | 9,200 |

Summary of conditions for a counterparty to receive an equity instrument granted and of accounting treatments

IG24 The table below categorises, with examples, the various conditions that determine whether a counterparty receives an equity instrument granted and the accounting treatment of share-based payments with those conditions.

| Summary of conditions that determine whether a counterparty receives an equity instrument granted | | | | | | |
|---|---|--|---|--|---|---|
| | VESTING CONDITIONS | | | NON-VESTING CONDITIONS | | |
| | Service conditions | Performance conditions | | Neither the entity nor the counterparty can choose whether the condition is met | Counterparty can choose whether to meet the condition | Entity can choose whether to meet the condition |
| | | Performance conditions that are market conditions | Other performance conditions | | | |
| <i>Example conditions</i> | Requirement to remain in service for three years | Target based on the market price of the entity's equity instruments | Target based on a successful initial public offering with a specified service requirement | Target based on a commodity index | Paying contributions towards the exercise price of a share-based payment | Continuation of the plan by the entity |
| <i>Include in grant-date fair value?</i> | No | Yes | No | Yes | Yes | Yes ^(a) |
| <i>Accounting treatment if the condition is not met after the grant date and during the vesting period</i> | Forfeiture. The entity revises the expense to reflect the best available estimate of the number of equity instruments expected to vest. | No change to accounting. The entity continues to recognise the expense over the remainder of the vesting period. | Forfeiture. The entity revises the expense to reflect the best available estimate of the number of equity instruments expected to vest. | No change to accounting. The entity continues to recognise the expense over the remainder of the vesting period. | Cancellation. The entity recognises immediately the amount of the expense that would otherwise have been recognised over the remainder of the vesting period. | Cancellation. The entity recognises immediately the amount of the expense that would otherwise have been recognised over the remainder of the vesting period. |
| | (paragraph 19) | (paragraph 21) | (paragraph 19) | (paragraph 21A) | (paragraph 28A) | (paragraph 28A) |
| (a) In the calculation of the fair value of the share-based payment, the probability of continuation of the plan by the entity is assumed to be 100 per cent. | | | | | | |

Table of Concordance

This table shows how the contents of IFRIC 8 and IFRIC 11 correspond with IFRS 2 (as amended in 2009).

| IFRIC 8 paragraph | IFRS 2 (amended) paragraph | IFRIC 11 paragraph | IFRS 2 (amended) paragraph |
|-------------------|----------------------------|--------------------|----------------------------|
| 1 | 2 | 1 | B48 |
| 2, 3 | IG5A, IG5B | 2, 3 | B51, B52 |
| 4 | None | 4–6 | B46 |
| 5 | IG5C | 7 | B49 |
| 6 | 2 | 8 | B53 |
| 7, 8 | 2 | 9 | B59 |
| 9 | 2 | 10 | B61 |
| 9–12 | 13A | 11 | B55 |
| 13, 14 | 64 | 12, 13 | 64 |
| IE1–IE4 | IG Example 1 | IE1–IE4 | IG Example 14 |
| BC1–BC5 | BC18A–BC18D | BC1, BC2 | None |
| BC6–BC12 | BC128B–BC128H | BC3–BC18 | None |
| BC13 | None | BC19 | BC268P |
| | | BC20 | None |
| | | BC21, BC22 | BC268Q, BC268R |

