February 2006

EXPOSURE DRAFT OF PROPOSED

Amendments to IFRS 2 Share-based Payment

Vesting Conditions and Cancellations

Comments to be received by 2 June 2006

International
Accounting Standards
Board®

Exposure Draft of Proposed

AMENDMENTS TO IFRS 2 SHARE-BASED PAYMENT:

VESTING CONDITIONS AND CANCELLATIONS

Comments to be received by 2 June 2006

This Exposure Draft of proposed Amendments to IFRS 2 Share-based Payment—*Vesting Conditions and Cancellations* is published by the International Accounting Standards Board (IASB) for comment only. The proposals may be modified in the light of the comments received before being issued in final form as amendments to IFRS 2. Comments on the Exposure Draft and the Basis for Conclusions should be submitted in writing so as to be received by **2 June 2006**.

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

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Introduction

1 This Exposure Draft contains proposals by the International Accounting Standards Board to amend IFRS 2 *Share-based Payment* to define vesting conditions and clarify the accounting treatment of cancellations by parties other than the entity.

2 IFRS 2 describes vesting conditions as including service conditions and performance conditions. It is silent on whether other features of a share-based payment transaction are vesting conditions.

3 IFRS 2 specifies the accounting treatment when an entity cancels a grant of equity instruments. It does not state how cancellations by a party other than the entity should be accounted for.

4 These issues were considered by the International Financial Reporting Interpretations Committee (IFRIC) in its draft Interpretation D11 *Changes in Contributions to Employee Share Purchase Plans,* which was published for comment in December 2004. However, the IFRIC was subsequently unable to reach a consensus and the issues were referred to the Board. The Board agreed with the IFRIC that these issues should be clarified. Accordingly, this document sets out the Board's proposed definition of vesting conditions and guidance on the accounting treatment of cancellations by parties other than the entity.

Features of this Exposure Draft

5 The Exposure Draft proposes amendments that:

(a) restrict vesting conditions to service conditions and performance conditions;

(b) require cancellations by parties other than the entity, whether by employees, shareholders or any other parties, to be accounted for in the same way as cancellations by the entity (paragraph 28 of IFRS 2);

(c) require these changes to be applied in annual periods beginning on or after 1 January 2007. The amendments are to be applied retrospectively.

Invitation to Comment

The International Accounting Standards Board invites comments on the amendments proposed in this Exposure Draft, particularly on the questions set out below. Comments are most helpful if they:

(a) comment on the questions as stated;

(b) contain a clear rationale; and

(c) include any alternative the Board should consider, if applicable.

Respondents should submit comments in writing so as to be received no later than **2 June 2006**.

Question 1 – Vesting conditions

The Exposure Draft proposes that vesting conditions should be restricted to performance conditions and service conditions.

Do you agree? If not, what changes do you propose, and why?

Question 2 – Cancellations

The Exposure Draft proposes that cancellations by parties other than the entity should be accounted for in the same way as cancellations by the entity.

Do you agree that all cancellations should be treated in the same way? If not, please specify the nature of any differences between types of cancellations and explain how they influence the selection of appropriate accounting requirements.

Question 3 – Effective date and transition

The proposed changes would apply to periods beginning on or after 1 January 2007, and would be required to be applied retrospectively. Earlier application would be encouraged.

Are the proposed effective date and transition appropriate? If not, what do you propose, and why?

Proposed Amendments to IFRS 2 *Share-based Payment*

In Appendix A, the definition of **vesting conditions** is amended (new text is underlined and deleted text is struck through) as follows.

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

Paragraph 28 is amended (new text is underlined and deleted text is struck through) as follows.

28 If ~~the entity cancels or settles~~ a grant of equity instruments is cancelled or settled during the vesting period (other than a grant cancelled by forfeiture when the vesting conditions are not satisfied) …

Paragraph 61 is added, as follows.

61 An entity shall apply the following amendments retrospectively in annual periods beginning on or after 1 January 2007:

(a) the revised definition of vesting conditions in Appendix A;[*]

(b) the amendment in paragraph 28.[†]

Earlier application is encouraged. If an entity applies the amendments above for a period beginning before 1 January 2007, it shall disclose that fact.

[*] Vesting conditions are either ~~include~~ service conditions, … ~~and~~ or performance conditions…

[†] If ~~the entity cancels or settles~~ a grant of equity instruments is cancelled or settled.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, the proposed Amendments to IFRS 2.

Introduction

BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching the conclusions in the Exposure Draft of Proposed Amendments to IFRS 2—*Vesting Conditions and Cancellations.* Individual Board members gave greater weight to some factors than to others.

Vesting conditions

BC2 IFRS 2 states that vesting conditions include service and performance conditions. Paragraph BC171 of the Basis for Conclusions to IFRS 2 describes vesting conditions as those conditions that ensure that the counterparty provides the services required to 'pay' for the equity instruments issued. For example, service conditions are imposed to ensure that employees provide a minimum period of service in return for the equity instruments. Performance conditions are usually imposed to ensure that a minimum level or quality of service is provided by using performance targets as an incentive.

BC3 In developing these proposals, the Board considered whether other features of a share-based payment transaction should be regarded as vesting conditions. For example, some employee share purchase plans require employees to make regular plan contributions over a specified period. In other plans, employees may be awarded an initial grant of shares in a matching share scheme. If the initial grant of shares has not been sold or transferred during a specified period an additional grant of shares is awarded at a future date.

BC4 The Board acknowledged that additional features, such as a contribution requirement or a requirement to hold an initial grant of shares, may constitute terms that must be satisfied in order for the equity instrument to be issued to the counterparty. These additional features are taken into account in the measurement of the fair value of the equity instrument. However, they are not vesting conditions because they do not ensure that the counterparty provides the services required to 'pay' for the equity instruments.

BC5 More generally, the Board noted that the only conditions that ensure the counterparty provides the services required to 'pay' for the equity instruments granted are either the service conditions themselves, or the conditions that directly affect the services rendered. Therefore, the Board concluded that vesting conditions are either service conditions or performance conditions. No other features should be considered vesting conditions.

Cancellations

BC6 The Board noted that cancellations can be separated into three categories: cancellations by the entity, cancellations by the counterparty (eg an employee or service provider) and cancellations by a third party (eg a shareholder). The Board considered the treatment of each type of cancellation and concluded that all cancellations should receive the same accounting treatment.

Cancellations by the counterparty

BC7 Counterparties may cancel their participation in a plan directly or indirectly by failing to meet a non-vesting condition.* For example, if an employee share purchase plan requires employees to make regular plan contributions over a specified period, the employees may cancel their participation in the plan indirectly by ceasing to make contributions to the plan.

BC8 The Board considered the four ways in which a counterparty cancellation could be accounted for. The entity could:

(a) reverse the expense charged to date (same as a forfeiture);

(b) cease recognising future expense from the date of cancellation;

(c) continue recognising the expense as if the cancellation had not occurred; or

(d) accelerate the recognition of the remaining expense (same as a cancellation by the entity).

BC9 The Board noted that the primary objective of IFRS 2 is to measure the value of goods or services received in return for the equity instruments granted. If a counterparty cancels participation in a plan, this does not imply that the services required to pay for the equity instrument have not been (or will not be) rendered.

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* Failure to meet a vesting condition is a forfeiture.

BC10 Furthermore, if the event were a forfeiture, a reversal of the expense would be appropriate because no adjustment for forfeitures is included in the grant date fair value of the equity instrument.* However, the fair value of the equity instrument takes into account all the factors that a knowledgeable, willing market participant would take into account at the grant date, including the probability that counterparties will cancel their participation in a plan.

BC11 Therefore, the Board concluded that, when a cancellation by a counterparty occurs, reversing the expense or ceasing to recognise future expense would be inappropriate, because this would be inconsistent with the primary objective of measuring the value of the goods or services received and with the grant date measurement approach.

BC12 The Board then considered whether the entity should continue to recognise the expense as if the cancellation had not occurred or accelerate the recognition of the remaining expense (as with a cancellation by the entity). In particular, the Board deliberated whether a cancellation by a counterparty should be treated differently from a cancellation by the entity.

BC13 The Board observed that in some cases, legal, taxation or other factors can make it difficult to identify whether the entity or the counterparty cancelled the counterparty's participation in the plan.

BC14 Suitable non-arbitrary and unambiguous criteria would be needed to distinguish these events. The Board observed that such criteria do not exist at present and that to develop them would be difficult and involve a lengthy process. The Board was not convinced that the potential improvement in financial reporting would be commensurate with the resources that would be required.

BC15 The Board also noted that requiring more than one method of accounting for cancellations would create incentives for structuring transactions to achieve a desired accounting result, particularly because the different methods being considered (ie the acceleration of expense method and the continuation of expense method) produce significantly different accounting results.

BC16 Therefore, the Board concluded that a cancellation by the counterparty should be treated in the same way as a cancellation by the entity.

* Where the goods or services received are measured by reference to the fair value of the equity instruments granted.

Cancellations and settlements by other parties

BC17 The Board also noted that a cancellation or settlement by an entity is economically equivalent to a cancellation or settlement by a third party on the entity's behalf and should therefore receive the same accounting treatment.

Cancellations and termination of employment

BC18 Some have argued that there is an apparent discrepancy between the treatment of cancellations by employees immediately before they leave service (which are cancellations) and cancellations by employees on leaving service (which are forfeitures).

BC19 The Board observed that this apparent discrepancy could arise only when it is clear that the employees are cancelling their participation in the plan as a consequence of their expected termination of employment. Moreover, the Board noted that, in this case, it would be clear that the grant has been cancelled by forfeiture and, furthermore, that paragraph 28 of the IFRS does not require grants that are cancelled by forfeiture to be treated as cancellations. Therefore, the Board does not propose to issue any additional guidance.

Consistency with US GAAP

BC20 The Board noted that the relevant requirements of the US standard SFAS 123 (revised 2004) *Share-based Payment* are the same as the proposed Amendments. In particular, vesting conditions are restricted to service conditions and performance conditions and all cancellations receive the same accounting treatment.

Transition requirements

BC21 IFRS 2 became effective on 1 January 2005. The Board noted that if an entity's financial statements in previous years contain any material disclosed or undisclosed departures from the requirements of the proposed Amendments, the entity would be required to apply IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* in correcting them. However, entities that have applied IFRS 2 should have sufficient information to apply the proposed Amendments retrospectively.

BC22 The Board also noted that the entity is not required to apply IFRS 2 to share-based payments that have been cancelled before the date of transition. Therefore, entities that will adopt the standard for the first time would not need to apply an unacceptable level of hindsight in applying the proposed Amendments.

BC23 Accordingly, the Board concluded that the proposed Amendments should be applied retrospectively and that no specific transition requirements should be proposed.