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Share-based Payment

A practical guide to applying IFRS 2

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Key issues for management

IFRS 2, Share-based Payment, has a far-reaching impact, and its adoption will be a challenge for some companies. Management needs to consider a number of issues in implementing the standard.

IFRS 2 captures the purchase of all goods or services settled in an entity's own equity instruments or in cash, if the amount payable depends on the price of the entity's shares (or other equity instruments, such as options).

Remuneration committees should look at the terms and conditions of existing or planned schemes in order to understand the information that will now be disclosed. Investors will expect to see awards justified against the new benchmark.

Estimates are now required of the number of options or other instruments expected to be exercised. Such estimates are complex to calculate where performance criteria, such as earnings targets, are involved. Specialist valuation skills are likely to be required in order to determine the amounts to be reported in the financial statements.

Companies will now need to assess the impact of IFRS 2 and agree a strategy of how to convey this to stakeholders. Management should particularly consider the potential effect in the income statement from cash-settled schemes, and information about existing or planned share-based payment schemes.

IFRS 2 is already applicable to certain share-based payments, even for first-time adopters. It is time to take action to determine what changes to compensation and accounting systems will be necessary.

Ian Wright
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1. Introduction

The scope of IFRS 2, Share-based Payment, encompasses virtually all transactions to purchase products or services involving the issuance of shares or payments that are based on the market price of the entity's shares. The impact on an entity's income statement will affect the financial statements and the way companies design compensation arrangements for their employees. Share-based payment transactions have to be included in the financial statements (not just disclosed), and an expense should be recognised when the goods and services are consumed.

The implementation of the standard will require careful planning, data collection and the use of valuation models. For companies that use shares to pay employees and/or suppliers, it will involve:

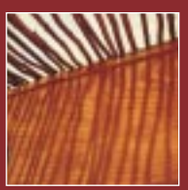
- **Initial impact study** – to evaluate the impact on the financial statements and review the design, data sources and collection processes for share-based payment arrangements;
- **Planning phase** – to assess the training needs, decide valuation processes and identify roles and responsibilities;
- **Preparation phase** – focusing on the collection of data, the selection of the assumptions and the actuarial valuations; and
- **Implementation phase** – resulting in the actual accounting entries and disclosures, and the development of plans for communicating with investors and analysts.

'Share-based Payment – a practical guide to applying IFRS 2' provides comprehensive worked examples, including valuation considerations and detailed calculations of the accounting charge, and demonstrates the practical challenges of implementation.

2. IFRS 2 requirements

IFRS 2 applies to all types of share-based payment transactions. These include:

Equity-settled	An entity issues or transfers its own *equity instruments*[1], or those of another member of the same group, as consideration for goods or services.
Cash-settled	An entity, or another member of the same group, pays cash calculated by reference to the price of its own *equity instruments* as consideration for goods or services.
Choice of equity-settled or cash-settled	An entity or the supplier may choose whether the entity settles in cash or by issuing or transferring *equity instruments*.



Goods acquired in share-based payment transactions include inventories, consumables, property, plant and equipment, and intangible and other non-financial assets.

There are few exclusions from the scope of IFRS 2. These relate to transactions that are dealt with by other standards, namely:

- **Business combinations to which IAS 22 or IFRS 3 applies,** even if the transaction is equity settled; and
- **Contracts for the purchase of goods that are within the scope of IAS 39,** such as commodity contracts entered into for speculative purposes, ie, other than to satisfy the reporting entity's expected purchase or usage requirements.

Transactions with *employees* and shareholders generally in their capacity as owners of *equity instruments* are also outside the scope of IFRS 2 (for example, if a company makes a rights issue of shares to all shareholders and these include some of the company's *employees)*.

Examples of arrangements that come under IFRS 2 are:

- Call options that give employees the right to purchase an entity's shares in exchange for their services;
- Share appreciation rights that entitle *employees* to payments calculated by reference to the market price of an entity's shares or the shares of another entity in the same group;
- In-kind capital contributions of property, plant or equipment in exchange for shares or other *equity instruments*;
- Share ownership schemes under which *employees* are entitled to receive an entity's shares in exchange for their services; and
- Payments for services made to external consultants that are calculated by reference to the entity's share price.

Effective date

IFRS 2 is effective for accounting periods beginning on or after 1 January 2005, with early adoption encouraged. The standard contains detailed transitional guidance – see page 18.

[1] The terms shown in *italics* are defined in the glossary on page 52.

Share-based payment transactions

IFRS 2 requires an expense (or an increase in assets, where relevant) to be recognised for goods or services acquired. The corresponding amount will be recorded either as a liability or as an increase in equity, depending on whether the transaction is determined to be cash- or equity-settled. The amount to be recorded is measured at the *fair value* of those goods and services or, in certain circumstances, at the *fair value* of the shares or *share options*.

Equity-settled transactions

An example of an equity-settled transaction is the issuance of options to *employees* that give them the right to purchase the entity's shares at a discounted price in exchange for their services.

When should a charge be recognised?

Goods or services acquired in a share-based payment transaction should be recognised when they are received. It will usually be a question of fact as to when this occurs, such as when goods are delivered. However, sometimes it is less obvious as to when the services are received.

The vesting date is not normally relevant to the purchase of goods or services other than employee services. It is, however, relevant for employee services. Where *equity instruments vest* immediately, management should presume that they represent consideration for employee services already rendered, if there is no evidence to the contrary. Management should therefore recognise the *employee* services received in full on the date on which the options are granted.

If the options do not *vest* until the *employees* or others providing similar services have completed a specified period of service, management should presume that services are to be rendered over that period, referred to as 'the *vesting period*'. IFRS 2 does not distinguish between *vesting periods* during which the *employees* have to satisfy specific performance conditions and *vesting periods* during which there are no particular requirements other than to remain in the entity's employment.

Example – Vesting period

A company grants *share options* to its *employees*. Certain performance conditions need to be satisfied over the next three years for the options to be exercisable. The employee has to remain working for the company during this period to become entitled to the award.

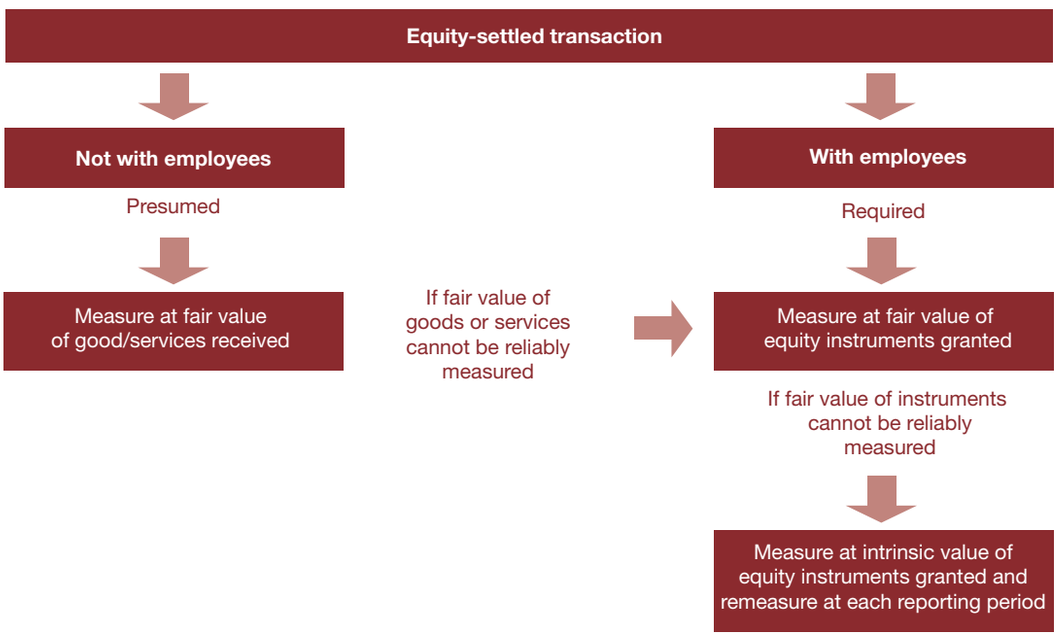
The *employees* provide their services over the three-year *vesting period* in exchange for the granted options. The expense should therefore be recognised over this period.

How are equity-settled transactions reflected in the financial statements?

An expense (or increase in assets if the criteria for asset recognition are met) arises out of a share-based payment transaction. The credit side of the entry will be a liability if the entity has an obligation to settle the transaction in cash. However, if there is no possibility of settling in cash, and the consideration for goods and services will therefore be achieved through the issuance of *equity instruments*, the credit entry is an increase in equity.

How should the charge be measured?

IFRS 2 requires the *fair value* of the goods or services acquired by an entity to be determined and used as the value for an equity-settled share-based payment transaction. However, if the *fair value* of the goods or services cannot be measured reliably, the transactions should be measured indirectly by reference to the *fair value* of the *equity instruments* granted. In these circumstances, the *fair value* of the *equity instruments* granted represents a surrogate for the price of the goods and services. Shares and *share options* are often granted to *employees* as part of their remuneration package, in addition to salary and other employment benefits. IFRS 2 requires an entity to measure the *fair value* of the employee services received by reference to the *fair value* of the *equity instruments* granted. It presumes that remuneration components cannot be measured reliably. These requirements are illustrated below.



Measurement date

The *fair value* of the *equity instruments* granted as consideration should be measured at either:

- The *grant date* in the case of employee services; or
- The date on which goods are received or services are rendered, in all other cases.

The grant date is when the parties have obtained an understanding of all the terms and conditions of the arrangement.

Example – Date of approval

In February 2005, the company offered options to new *employees,* subject to shareholder approval. The awards were approved by the shareholders in June 2005. The *grant date* is June 2005, when the approval is obtained.

Determining fair value of equity instruments

Fair value should be based on market prices, where available. Many shares and most *share options* are not traded on an active market, in which case management should consider valuation techniques. The objective is to derive an estimate of the price of the instrument at the relevant measurement date in an arm's length transaction between knowledgeable, willing parties. IFRS 2 does not specify which pricing models should be used. However, it describes the factors that should be taken into account when estimating *fair value* – see Appendix A (page 50).

Share options are often valued using the *Black-Scholes model*, the *Binomial model* or the *Monte-Carlo model*. Further information on option valuation techniques is included in Appendix A, page 50.

In the absence of a reliable measure of *fair value*, IFRS 2 requires an entity to measure the *equity instruments* granted at their *intrinsic value* – that is, the difference between the *fair value* of the shares and amount that the counterparty is required to pay for them. The *intrinsic value* should then be remeasured at each reporting date until the *equity instruments* are settled.

Vesting conditions

Many employee *share option* arrangements contain conditions that must be met before an *employee* becomes entitled to shares or options (*vesting conditions*). There may be performance conditions that must be satisfied. For example, the number of options to which *employees* are entitled under a bonus arrangement may depend on a certain increase in profit or growth in the company's share price.

The treatment of *vesting conditions* varies depending on whether or not any of the conditions relate to the market price of the entity's *equity instruments*. Such conditions, defined by IFRS 2 as *'market conditions'*, are taken into account when determining the *fair value* of the *equity instruments* granted; they are ignored for the purposes of estimating the number of *equity instruments* that will *vest*.

For conditions other than *market conditions*, the goods or services recorded during the *vesting period* are based on the best available estimate of the number of *equity instruments* expected to *vest*. The estimate is revised when subsequent information indicates that the number of *equity instruments* expected to *vest* differs from previous estimates; it is revised finally to the actual number of instruments that *vested*.

Is the vesting condition market-based?

Yes	No
Include in determining the fair value of the grant date, and do not revise vesting estimate each period	Ignore in determining the fair value of the grant date, and revise vesting estimate each period
Examples: – Minimum increase in share price – Total shareholder return	Examples: – Achievement of sales target – Achievement of minimum earnings target

Example – Market vesting conditions

A company granted *share options* that become exercisable when the market price increases by at least 10% in each year over the next three years. At the end of year three, this target has not been met.

The company should not revise the *grant date fair value* and should not reverse the employee benefits expense already recognised, because the increase in share price is a market-based criterion. It was included in determining the *fair value* of the *options* at the *grant date.*

For non-market conditions, the entity should revise the estimate of the number of *equity instruments* expected to *vest*.

Example – Changes in vesting estimates

A company granted *options* to its *employees* with a fair value of €300,000, determined using the *Black-Scholes model*, and made the following estimates:

Estimate at *grant date* of the percentage of *employees* leaving the company before the end of the three-year *vesting period;*	**10%**
Revised estimate, made in the second year, of the portion of employees leaving the company before the end of three years;	**5%**
Actual percentage of leavers; and	**6%**

The expense in the first year should be €90,000 (€300,000 x 1/3 x 90%). As a result of a change in accounting estimate of the percentage of *employees* expected to leave, an expense of €100,000 will be recognised in the second year. The cumulative expense at the end of the second year is €190,000 (€300,000 x 2/3 x 95%).

At the end of the third year, 94% of the *options vest,* so the cumulative expense over the *vesting period* is €282,000 (€300,000 x 3/3 x 94%), and the expense in the third year is €92,000 (€282,000-€190,000).

If a non-market vesting condition is not ultimately met, the expense previously recognised is reversed.

Example – Non-market vesting condition

Management introduced a new equity-settled compensation plan with a non-market performance condition. During the following year, after a downturn in the company's fortunes, it considers that there is no chance that it will meet the target. The cumulative expense at the end of the second year will be adjusted to nil, and the charge is reversed in the current year.

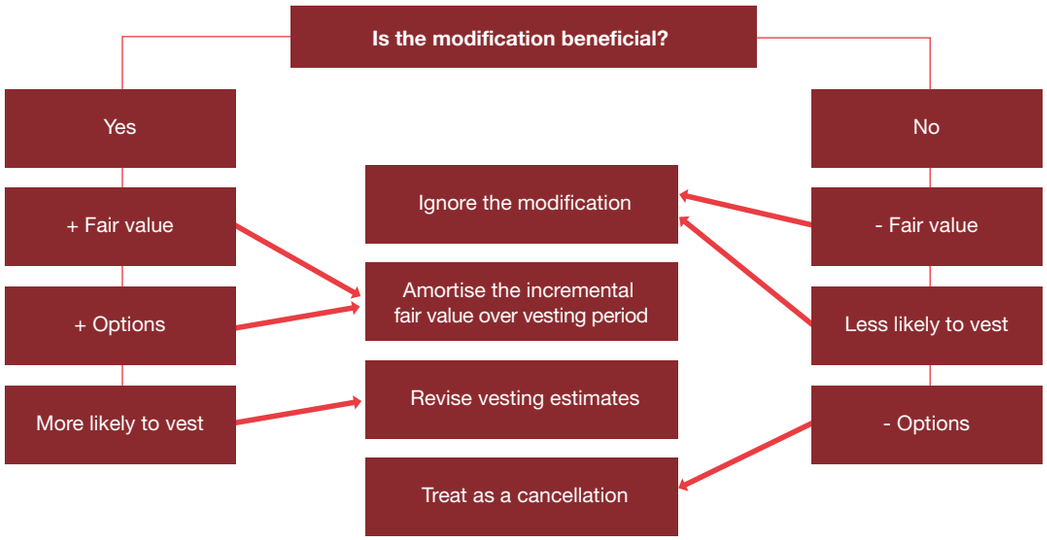
Post-vesting date accounting

No adjustments (other than reclassification within equity) are made after the *vesting* date. For example, in the case of *share options,* no adjustments are made even if the options are not exercised.

A number of comprehensive examples that illustrate accounting for equity-settled share-based payment transactions are included in Section 3, 'Applying IFRS 2 in practice'. The examples are 'Share options granted to key executives' (page 21), 'Performance conditions – an increase in earnings' (page 25), 'Save as you earn schemes' (page 38), 'In-kind capital contributions' (page 42), and 'Shares for services' (page 44).

Modifications

Modifications should be viewed as incremental instruments in their own right. The standard requires an entity to ignore a modification if it does not increase the total *fair value* of the share-based payment arrangement or is not otherwise beneficial to the *employee* or service provider. However, reductions in the number of options granted are treated as cancellations. The diagram below illustrates the thought-process.



If a modification increases the *fair value* of the *equity instruments* granted (for example, by reducing the exercise price of *share options*), the incremental *fair value* should be added to the amount being recognised for the services received. If a modification increases the number of *equity instruments* granted, the *fair value* of these additional instruments is added to the amount recognised. In each case, this will be in addition to any amount recognised in respect of the original instrument, which should continue to be recognised over the remainder of the original *vesting period* unless there is a failure to satisfy the original non-market *vesting conditions*.

If a modification occurs during the *vesting period*, the incremental *fair value* should be recognised over the period from the modification date until the date on which the modified *equity instruments vest*. If the modification occurs after the *vesting* date, the incremental *fair value* should be recognised immediately, or over the revised *vesting period* if the employee is required to complete an additional period of service before becoming unconditionally entitled to the modified instruments.

If a modification provides some other benefit to *employees,* this should be taken into account in estimating the number of *equity instruments* that are expected to *vest*. For example, a *vesting condition* might be eliminated.

Example – Beneficial modification

An entity granted 100 *share options* to each of its five key executives. The *share options vest* only if the entity achieves its next year's sales target of €100 million. During the year the sales target was revised to €90 million.

A reduction in the sales target makes the options more likely to *vest,* and the entity recognises an increased expense.

A comprehensive example 'Share options – repricing' that illustrates accounting for a modification of a share option scheme is provided on page 28.

Cancellations

An entity may cancel and replace a grant of *equity instruments*. In this case, the incremental *fair value* is the difference between the *fair value* of the replacement instruments and the *fair value* of the original instruments. The replacement is treated as a modification.

Early settlements

An entity may cancel or early settle an award without replacement. On early settlement, the entity should recognise immediately the balance that would have been charged over the remaining period.

Any payment made to *employees* in connection with the cancellation of a grant of an *equity instrument* should be deducted from equity, except where the payment exceeds the *fair value* of the *equity instrument* at that date. In this case, the excess is recognised as an expense.

Cash-settled transactions

Cash-settled share-based payment transactions are where goods or services are paid for at amounts that are based on the price (or value) of the entity's shares or other *equity instruments* (such as *share options*). An example of a cash-settled transaction is share appreciation rights issued to employees. These entitle *employees* to cash payments equal to the increase in the share price of a specified number of the entity's shares.

The principles that apply to cash-settled share-based payment transactions are:

- Goods or services should be recognised as they are received by the entity;
- Goods or services acquired should be measured at the *fair value* of the liability incurred; and
- *Vesting conditions* should be taken into account when estimating the number of rights to payment that will *vest*.

The *fair value* of the liability incurred in respect of a cash-settled transaction is remeasured at each reporting date until the date of settlement.

Changes that affect the *fair value* of the awards, as well as those that affect the number of awards expected to *vest,* will be updated at each reporting date as part of the remeasurement process and used to determine the amount to be recognised.

Example – Share appreciation rights

A company granted share appreciation rights to its 100 *employees* in March 2003, *vesting* in March 2007. The following estimates were made by management in March 2004:

Estimate of the awards that will *vest*	**80%**
Fair value of each share appreciation right at March 2004	**€5,000**

The *fair value* of the liability to be recorded in March 2004 is €100,000 (100 x €5,000 x 80% x 1/4).

Management revised its estimates in March 2005 as follows:

Estimate of the awards that will *vest*	**90%**
Fair value of each share appreciation right at March 2005	**€6,000**

The accrued liability at that reporting date is €270,000 (100 x €6,000 x 90% x 2/4). The increase in the liability of €170,000 (€270,000-€100,000) is recognised as an expense in the income statement within 'employee costs'.

The payment for settlement of a cash-settled share-based transaction may occur after the services are rendered. In those situations, the liability is still measured at *fair value* at each reporting date. Any changes in the *fair value* of the liability are recognised immediately in the income statement.

Example – Remeasurement of share appreciation rights after vesting

A company granted share appreciation rights to 1,000 *employees* on 1 January 2005 based on 1 million shares. The rights *vest* on 31 December 2005, but payment is in January 2007. The share price at 1 January 2005 was €8, at 31 December 2005 it was €10, and at 31 December 2006 it was €9.

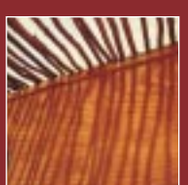
A liability is recognised at 31 December 2005 of €2 million (1 million shares x (€10-€8)). In 2006 the company should recognise a gain of €1 million (1 million shares x (€10-€9)), and reduce the liability to €1 million.

A comprehensive example of share appreciation rights on p31 illustrates accounting for cash-settled share-based payment transactions with *employees*.

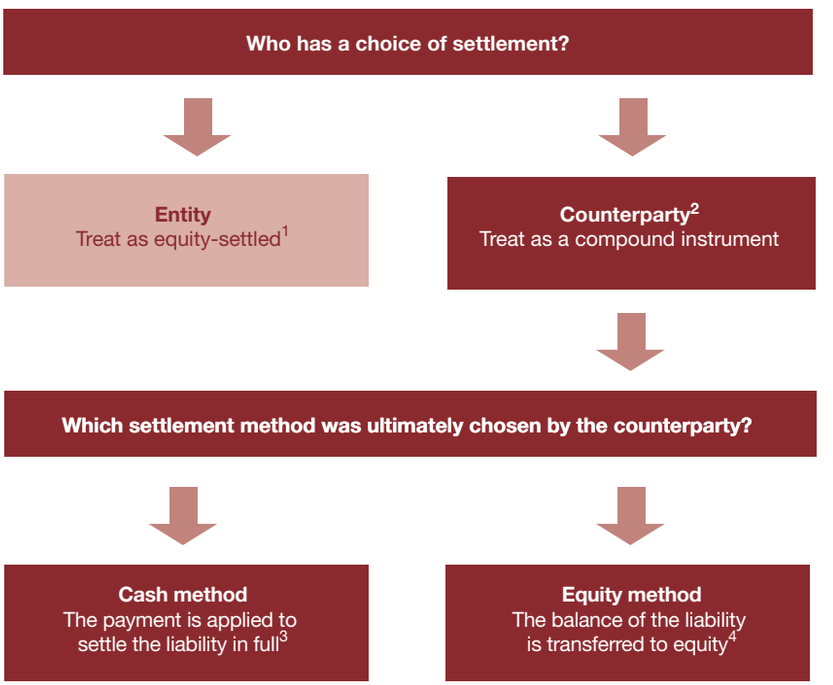
Arrangements with settlement alternatives

Some share-based payment transactions give either the entity or the counterparty the choice as to whether to settle in cash or *equity instruments*. For example, an *employee* may have a right to choose between a payment equal to market price of 100 shares or 150 shares subject to not selling them for at least one year.

IFRS 2 requires an entity to account for such a transaction as cash-settled if, and to the extent that, it has incurred a liability to settle in cash. The accounting depends on which party has the choice of settlement method.



Counterparty chooses the settlement method



1 See also diagram on page 16.

2 See also 'Entity chooses settlement method' on page 16.

3 If the counterparty chooses settlement in cash, any equity component previously recognised in equity will remain there, although there might be a transfer from one component of equity to another.

4 If the counterparty chooses settlement in equity instruments, the balance of the liability is transferred to equity as consideration for the equity instrument.

If the counterparty chooses the settlement method, the entity is considered to have issued a compound financial instrument. This means that it has issued an instrument with a debt component (where the counterparty has a right to demand cash) and an equity component (where the counterparty has a right to demand settlement in *equity instruments*).

IFRS 2 requires a different method than that required by IAS 32 (revised 2003) to determine the value of the constituent parts of a compound instrument. The liability is measured at *fair value*. For transactions in which the *fair value* of goods or services is measured directly, the *fair value* of the equity component is measured as the difference between the *fair value* of the goods or services received and the *fair value* of the debt component.

Equity component = **Fair value of the goods or services** less **Fair value of the debt component**

Example – Goods or non-employee services with settlement alternatives

An entity purchased 10kg of gold worth €80,000. The supplier can choose how the purchase price is settled. It can:

a) receive 100 of the entity's shares two years after delivery (the *fair value* of this alternative is estimated at €87,000 at the date of purchase); or

b) obtain a payment equal to the market price of 90 shares at the end of the first year after delivery (*fair value* of this alternative is estimated at €75,000 at the date of purchase).

At the date of obtaining the 10kg of gold, the entity should record a liability of €75,000 and an increase in equity of €5,000, determined as the difference between the value of 10kg of gold of €80,000 and *fair value* of the liability of €75,000.

For other transactions in which the *fair value* of goods or services (including employee services) is measured indirectly by reference to the *fair value* of the instruments granted, the *fair value* of the compound instrument as a whole should be estimated. The debt and equity components should be valued separately, taking into account the fact that the counterparty must forfeit its right to receive cash in order to receive the *equity instrument*.

Equity component = **Fair value of equity alternative, based on fair value of instruments granted** less **Fair value of the debt component**

Transactions are often structured in such a way that the *fair value* of each settlement alternative is the same. The *fair value* of the equity component will therefore be nil. However, where the *fair value* of the equity component is greater than nil, the components need to be split. The debt component should be accounted for as a cash-settled share-based payment transaction, as described on p12; the equity component will be accounted for as an equity-settled share-based payment transaction, as described on p7-12.

Example – Employee services with settlement alternatives

Employees entitled to a bonus may choose between obtaining a cash payment equal to the market price of 100 of the entity's shares, or obtaining 100 shares. The quoted market price of one share is €5.

The entity should record a liability of €500 for each entitled *employee*. The equity component is nil, being the difference between the *fair value* of 100 shares (€500) and the *fair value* of the alternative cash payment (€500).

At the date of settlement, the liability in respect of the debt component should be remeasured at *fair value*. The method of settlement chosen by the counterparty will then determine the final accounting.

An example that illustrates accounting for a transaction with settlement alternatives is provided on p35.

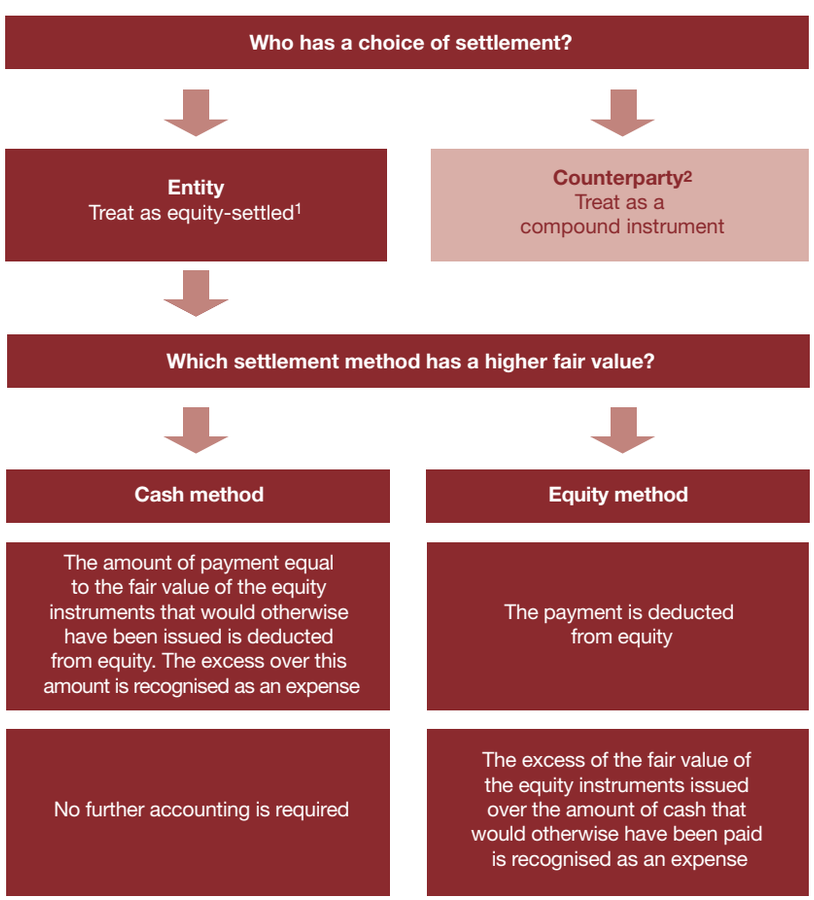
Entity chooses the settlement method

If the entity chooses the settlement method, it should determine whether it has created in substance an obligation to settle in cash. This is the case if, for example:

- The choice of settlement in *equity instruments* has no commercial substance;
- The entity has a past practice or stated policy of settling in cash; or
- The *equity instruments* to be issued are redeemable, either mandatorily or at the counterparty's option.

The entity should account for the transaction as a cash-settled share-based payment transaction, to the extent that it has incurred a liability.

If the transaction is accounted for as equity-settled, the accounting on settlement depends on which settlement alternative has the greater *fair value*, as shown in the diagram below.



[1] See also 'Entity chooses settlement method' above
[2] See also diagram on p14

Deferred tax implications

Tax deductions in some jurisdictions are available for share-based payment transactions. However, the amount of the deduction in the case of equity-settled transactions does not often correspond to the amount charged to the income statement in accordance with IFRS 2. For example, a tax deduction in connection with an employee *share option* scheme may be available at the time the options are exercised, measured on the basis of the options' *intrinsic value* (the difference between market price and exercise price) at that date.

IAS 12 provides guidance where an item has a tax base (the amount the tax authorities will permit as a deduction in future periods in respect of goods or services consumed to date), but the item is not recognised as an asset or liability in the entity's balance sheet. In the above example, employee services are expensed and their carrying amount is therefore nil, but an estimate of the value of the tax base at the end of each reporting period is determined by multiplying the options' *intrinsic value* at year-end by the proportion of the *vesting period* that has elapsed.

The difference between the tax base of the employee services received to date (the amount the tax authorities will permit as a deduction in future periods in respect of those services) and the carrying amount of nil is a deductible temporary difference that results in a deferred tax asset, if the entity has sufficient future taxable profits against which the deferred tax asset can be utilised.

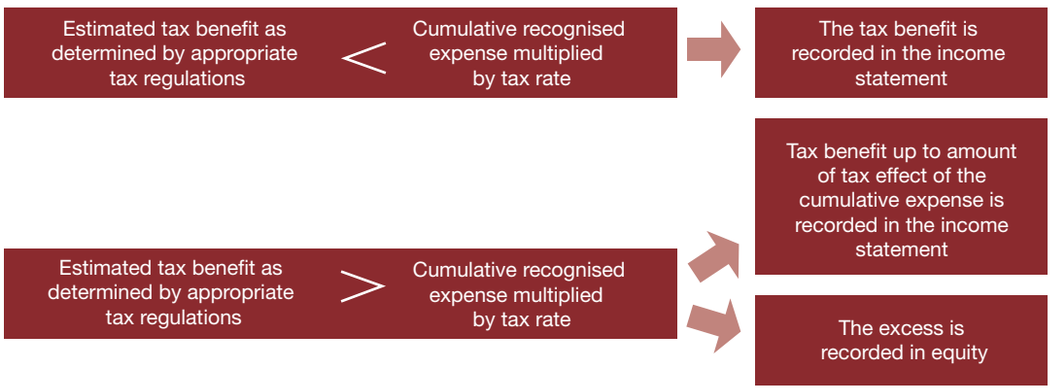
Measurement of the deferred tax asset

The deferred tax asset should be measured at each reporting date based on an estimate of the future tax deduction. The calculation of the future tax deduction depends on the specific tax jurisdiction; it is often based on the *intrinsic value* of options that are actually exercised. When this is the case, in order to estimate the future tax deductions, management should multiply the *intrinsic value* determined at the balance sheet date by the number of options expected ultimately to *vest*. The determined amount of the future tax deduction is spread over the *vesting period*. This is illustrated in the example on p18. The estimate of the tax deduction should be based on the current share price if the deduction is based on the *intrinsic value*.

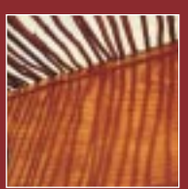
Recognition of the tax benefit

The expected future tax benefit should be allocated between the income statement and equity. The excess of the total tax benefit over the tax effect of the related cumulative remuneration expense is recognised in equity. The accounting is illustrated below.

Equity-settled transactions



Cash-settled transactions



Example – Tax benefit

On 1 January 2005, 100,000 options worth €200,000 are issued to *employees* subject to a two-year *vesting period.* A tax deduction is available at the exercise date for 30% of the options' *intrinsic value*. The options' *intrinsic value* was €160,000 at the end of the first year and €300,000 at the end of the second year.

At the end of the first year, the tax effect of the cumulative remuneration expense (€30,000, being 30% of the expense of €100,000) exceeds the tax benefit of €24,000 (30% of the *intrinsic value* of €160,000 x 50% vesting). Consequently, the tax benefit is recognised in the income statement.

At the end of the second year, when the options are exercised, a portion of the tax benefit is recognised in equity, as the tax benefit of €90,000 (30% of €300,000) exceeds the tax effect of the related cumulative remuneration expense (ie, €60,000, being €200,000 x 30%). The excess of €30,000 is recognised in equity. The amounts to be recorded are:

Year	Staff costs	Tax charged/(credited) to income statement		Tax charged/(credited) to equity		Balance sheet	
		Current tax	Deferred tax	Current tax	Deferred tax	Deferred tax	Current tax
1	€100,000	–	(€24,000)	–	–	€24,000	–
2	€100,000	(€60,000)	€24,000	(€30,000)	–	(€24,000)	€90,000
Total	€200,000	(€60,000)	–	(€30,000)	–	–	€90,000

Disclosures

IFRS 2 requires extensive disclosure under three main headings:

- Information that enables users of the financial statements to understand the nature and extent of share-based payment arrangements that existed during the period;
- Information that enables users of the financial statements to understand how the *fair value* of the goods or services received, or the *fair value* of the *equity instruments* granted, during the period was determined; and
- Information that enables users of the financial statements to understand the effect of expenses arising from share-based payment transactions on the entity's profit or loss for the period.

See p45 for an example of the type of disclosures required.

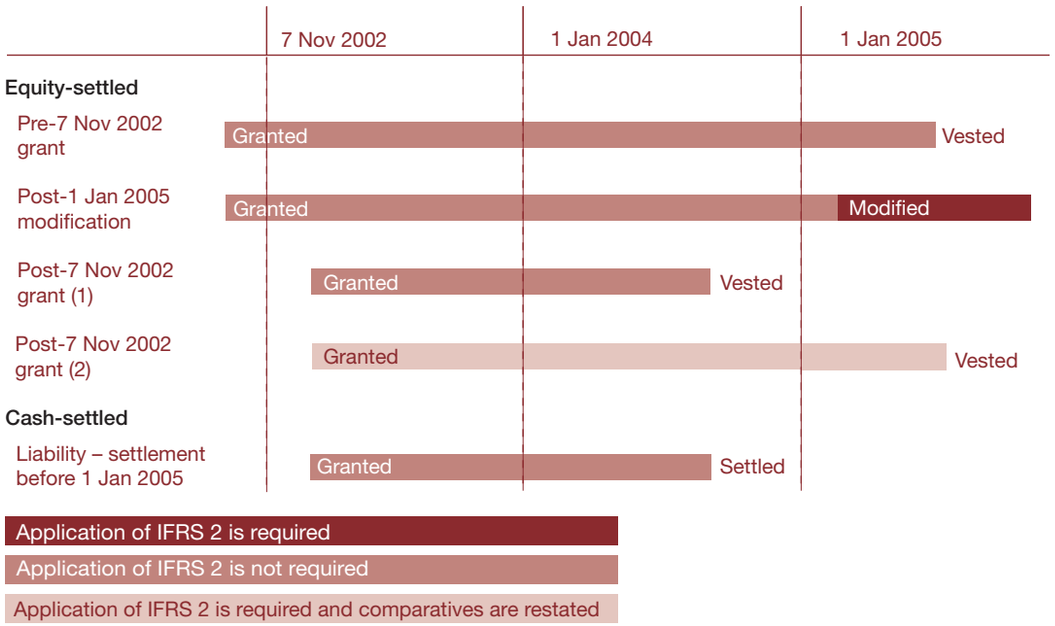
Transitional provisions

IFRS 2 requirements are effective for accounting periods beginning on or after 1 January 2005, with early adoption encouraged; but a key date for the standard's transitional provisions is 7 November 2002. This was the publication date of the share-based payments Exposure Draft.

The standard is applicable to *equity instruments* granted after 7 November 2002 not yet vested on the effective date of the standard (1 January 2005 for entities with a calendar-year accounting period that do not early adopt IFRS 2). Comparatives are restated for these equity-settled transactions. Application of IFRS 2 to other grants is encouraged if the *fair values* of the *equity instruments* at the measurement date have been publicly disclosed.

IFRS 2 applies to liabilities arising from cash-settled transactions that exist at 1 January 2005 (the effective date of the standard). Comparatives are restated for these liabilities only.

For all grants of *equity instruments* to which the requirements of IFRS 2 have not been applied, there should be sufficient disclosure to enable a user of the financial statements to understand the nature and extent of share-based payment arrangements that existed during the period. These requirements are illustrated in the timeline below.



First-time adopters

First-time adopters have to follow similar transitional provisions. The standard applies to grants of shares, *share options* or other *equity instruments* after 7 November 2002 and not *vested* at the later of the date of transition to IFRS (the beginning of the earliest period for which an entity presents full comparative information under IFRS in its first financial statements) and 1 January 2005. The table below illustrates how this should be applied for equity-settled awards.

Date of transition to IFRS	Later of date of transition and 1 January 2005	Applicability
1 January 2004	1 January 2005	Grants after 7 November 2002 not yet vested at 1 January 2005
1 April 2004	1 January 2005	Grants after 7 November 2002 not yet vested at 1 January 2005
1 January 2006	1 January 2006	Grants after 7 November 2002 not yet vested at 1 January 2006

The timeline above also applies to first-time adopters with a 1 January 2004 transition date.

Equity instruments to which IFRS 2 applies should be treated consistently in all accounting periods presented in a first-time adopter's financial statements – ie, comparatives will be restated for grants after 7 November 2002 not yet *vested* at the later of 1 January 2005 and the date of transition to IFRS.

First-time adopters will have to apply the standard retrospectively to all cash-settled transactions existing at the later of the date of transition to IFRS and 1 January 2005.

3. Applying IFRS 2 in practice

This section illustrates the accounting for the various types of share-based payment transactions that were entered into by fictional multinational company Wayne Holdings, Inc. (Wayne Holdings). It also provides the disclosures that Wayne Holdings is required to present for these transactions[1]. Wayne Holdings is a calendar-year IFRS preparer, and the recognition, measurement and disclosures are illustrated for its 31 December 2005 year-end.

Wayne Holdings applies IFRS 2 to all shares, *share options* and other *equity instruments* that were granted after 7 November 2002 and not *vested* as of 1 January 2005. Wayne Holdings also applies IFRS 2 to the modifications made after 1 January 2005 to the terms and conditions of *equity instruments* granted before 7 November 2002. Wayne Holdings applies IFRS 2 retrospectively to liabilities arising from share-based payment transactions existing at 1 January 2005.

A four-step approach has been taken in the analysis of the IFRS 2 transactions:

- **Step A:** Obtain the key data needed to perform the calculations;
- **Step B:** Make an initial estimate of the total amounts to be recorded;
- **Step C:** Determine the expense for each year and the corresponding journal entries; and
- **Step D:** Determine tax adjustments.

Details of factors to be considered in valuations of share-based payment transactions are included in Appendix A – 'Valuation considerations' (p50).

The section is followed by an illustrative set of disclosures relating to the above examples (p45).

[1] The numbers in this section are provided for illustrative purposes only. They do not necessarily reflect the results that actual share-based payment transactions would produce.

1. Share options granted to key executives

Wayne Holdings grants 100 *share options* to each of its 10 key executives at 1 January 2005, with the following conditions: (1) they must complete three years of service, and (2) there must be an 18% increase in share price by the end of 2007. Wayne Holdings estimates that its 10 executives will complete the three-year service period. The *fair value* of one option at *grant date* is €5. The *market condition* of an 18% increase in the share price has been included in the *fair value* of €5. The exercise price of each option is €3. The options have a contractual life of 10 years, and Wayne Holdings has estimated their value using a *Monte-Carlo model*.

Step A: Obtain the key data needed to perform the calculations

Grant date	1 January 2005
Vesting date	31 December 2007
Options per key executive	100
Fair value per option at grant date	€5
Number of employees entitled to options	10
Exercise price	€3
Departure rate (estimated at grant date)	0%
Market-based performance condition	18% increase in share price

Step B: Make an initial estimate of the total amount to be recorded

Step	Result	Explanation
Total fair value of one award	€500	100 options at a fair value of €5
Total number of awards expected to vest	10	10 x 100%
Total compensation expense	**€5,000**	**10 x 500**

Step C: Determine the expense for each year and the corresponding journal entries

At *grant date*, Wayne Holdings expected that none of the key executives would leave the company during the *vesting period*. No *employees* left Wayne Holdings during 2005, but two *employees* unexpectedly left the company during 2006. Wayne Holdings therefore revised its total compensation expense down to €4,000 (8 x €500). The increase in share price exceeded the increase in the share price threshold by the end of 2007. As a result, eight *employees vested* their options at the end of 2007. These options are exercised on 5 January 2008, and Wayne Holdings issues shares with a par value of €1 to its *employees*.

Year ended	Charge	Explanation
31 December 2005	€1,667	5,000 x 1/3
31 December 2006	€1,000	4,000 x 2/3 – 1,667 The charge recognised in 2005 for the two employees that unexpectedly left the company is adjusted in 2006
31 December 2007	€1,333	4,000 x 3/3 – 2,667
Total	**€4,000**	**8 employees x 500**

The journal entries are determined as follows:

(Amounts shown in euros)	**Dr**	**Cr**
1) Recognition of employee benefits expense in 2005		
Dr Employee benefits expense	1,667	
Cr Equity (separate component)		1,667
2) Recognition of employee benefits expense in 2006		
Dr Employee benefits expense	1,000	
Cr Equity (separate component)		1,000
3) Recognition of employee benefits expense in 2007		
Dr Employee benefits expense	1,333	
Cr Equity (separate component)		1,333
4) Recognition of shares issued on exercise (100 shares to 8 employees at a nominal value of €1 per share)		
Dr Equity (separate component)	4,000	
Cr Equity (share capital)		800
Cr Equity (share premium)		3,200
5) Receipt of the exercise price (100 shares to 8 employees at €3 per share)		
Dr Cash and cash equivalents	2,400	
Cr Equity (share premium)		2,400

Step D: Determine the tax adjustments

The tax legislation applicable to Wayne Holdings provides that the tax deduction relating to an equity-settled share-based payment transaction involving *share options* is based on the difference between the share price and the exercise price of an option at exercise date, which represents the *intrinsic value* for tax purposes. The following information will need to be gathered in order to determine the tax consequences of the *share options*.

	1 January 2005 (grant date)	31 December 2005	31 December 2006	31 December 2007 (vesting date)	5 January 2008 (exercise date)
Share price	€7	€9	€15	€22	€23
Exercise price	€3	€3	€3	€3	€3
Intrinsic value	€4	€6	€12	€19	€20
Number of options outstanding and expected to vest	1,000	1,000	800	800	800
Tax rate	40%	40%	40%	40%	40%
Compensation expense (cumulative)	–	€1,667	€2,667	€4,000	€4,000
Benefit based on intrinsic value	–	€2,000 (6 x 1,000) x 1/3	€6,400 (12 x 800) x 2/3	€15,200 (19 x 800) x 3/3	€16,000 (20 x 800)
Deferred tax asset (at 40%)	–	€800	€2,560	€6,080	–
Current tax receivable	–	–	–	–	€6,400 (16,000 x 40%)
Change in deferred tax asset	–	€800	€1,760	€3,520	(€6,080)
Deferred tax:					
– recognised in profit or loss	–	€667 (1,667 x 40%)	€400 (2,667 x 40% -667)	€533 (4,000 x 40% -667-400)	(€1,600) (4,000 x 40%)
– recognised in equity	–	€133 (800-667)	€1,360 (1,760-400)	€2,987 (3,520-533)	(€4,480) (133+1,360+ 2,987)

The journal entries are determined as follows:

(Amounts shown in euros)	**Dr**	**Cr**
1) Recognition of deferred tax asset at 31 December 2005		
Dr Deferred tax asset	800	
Cr Deferred tax income		667
Cr Equity (separate component)		133
2) Recognition of deferred tax asset at 31 December 2006		
Dr Deferred tax asset	1,760	
Cr Deferred tax income		400
Cr Equity (separate component)		1,360
3) Recognition of deferred tax asset at 31 December 2007		
Dr Deferred tax asset	3,520	
Cr Deferred tax income		533
Cr Equity (separate component)		2,987
4) Derecognition of deferred tax asset at the exercise date on 5 January 2008		
Dr Deferred tax expense	1,600	
Dr Equity (separate component)	4,480	
Cr Deferred tax asset		6,080
5) Recognition of current income tax benefit at the exercise date on 5 January 2008		
Dr Current income tax receivable	6,400	
Cr Current tax income (profit or loss)		1,600
Cr Equity (share premium)		4,800

2. Performance conditions – an increase in earnings

Wayne Holdings grants 100 shares to each of its 500 management-level *employees* at 1 January 2005, conditional upon the *employees* remaining in Wayne Holdings' employment during the *vesting period.* The shares will *vest* at the end of year one if the company's earnings increase by more than 10%; at the end of year two if the company's earnings increase by more than 15 % over the two-year period; and at the end of year three if the entity's earnings increase by more than 36% over the three-year period. The *fair value* of one share at *grant date* is €7.

Wayne Holdings's earnings have increased by 8% by the end of 2005, and 30 *employees* have left. The company expects that earnings will continue to increase at a similar rate in 2006 and therefore expects that the shares will *vest* at the end of 2006. Wayne Holdings also expects that an additional 30 *employees* will leave in 2006, and that 440 *employees* will receive their shares at the end 2006.

Step A: Obtain the key data needed to perform the calculations

Grant date	1 January 2005
Estimated vesting date (estimated at grant date and re-estimated each period)	31 December 2006
Shares per employee	100
Fair value per share at grant date	€7
Number of employees entitled to shares	500
Estimated departures	30 per year
Exercise price[1]	€0

Step B: Make an initial estimate of the total amount to be recorded

Step	Result	Explanation
Total fair value of one award	€700	100 shares at a fair value of €7
Total number of awards expected to vest	440	500-2 x 30
Total compensation expense	**€308,000**	**440 x €700**

Step C: Determine the expense for each year and the corresponding journal entries

By the end of 2006, Wayne Holdings' earnings in fact increase by 12% and the shares do not therefore *vest*. Additionally, only 28 *employees* leave during 2006, rather than 30 originally estimated by Wayne Holdings. Wayne Holdings believes that an additional 25 *employees* will leave in 2007 and earnings will increase so that the performance target will be achieved in 2007.

[1] A grant of shares effectively represents a grant of options with an exercise price of nil.

By the end of 2007, only 23 *employees* have left, compared with Wayne Holdings' original estimation of 25, and the performance target has been met. Wayne Holdings therefore revised the total compensation expense as follows:

Year ended	Charge	Explanation
31 December 2005	€154,000	440 x €700 x 1/2
31 December 2006	€40,600	(417 x €700 x 2/3)-€154,000
31 December 2007	€98,700	419 x €700 x 3/3-€154,000-€40,600
Total	**€293,300**	**419 x €700**

The journal entries are determined as follows:

(Amounts shown in euros)	**Dr**	**Cr**
1) Recognition of employee benefits expense for 2005		
Dr Employee benefits expense	154,000	
Cr Equity (separate component)		154,000
2) Recognition of employee benefits expense for 2006		
Dr Employee benefits expense	40,600	
Cr Equity (separate component)		40,600
3) Recognition of employee benefits expense for 2007		
Dr Employee benefits expense	98,700	
Cr Equity (separate component)		98,700
4) To record shares issued		
Dr Equity (separate component)	293,300	
Cr Equity (share capital at par value of €1 per share)		41,900
Cr Equity (share premium)		251,400

Step D: Determine the tax adjustments

The tax legislation applicable to Wayne Holdings provides that the tax deduction relating to this equity-settled share-based payment transaction is based on the share price at the *vesting* date. The following information will need to be gathered in order to determine the tax consequences of the compensation expense:

	31 December 2005	31 December 2006	31 December 2007 (vesting date)
Share price at each year end	€9	€15	€22
Number of shares expected to vest (in hundreds)	440	417	419
Tax rate	40%	40%	40%
Compensation expense (cumulative)	€154,000	€194,600	€293,300
Tax benefit based on intrinsic value	€198,000 (440 x 100 x 9 x 1/2)	€417,000 (417 x 100 x 15 x 2/3)	€921,800 (419 x 100 x 22 x 3/3)
Deferred tax asset (40%)	€79,200	€166,800	–
Current income tax (balance sheet)	–	–	€368,720 (921,800 x 40%)
Change in deferred tax asset	€79,200	€87,600	(€166,800)
Deferred tax:			
– recognised in the income statement	€61,600 (154,000 x 40%)	€16,240 (194,600 – 154,000) x 40%	(€77,840) (61,600+16,240)
– recognised in equity	€17,600 (79,200-61,600)	€71,360 (87,600-16,240)	(€88,960) (17,600+71,360)

The journal entries are determined as follows:

(Amounts shown in euros)	**Dr**	**Cr**
1) Recognition of deferred tax asset at 31 December 2005		
Dr Deferred tax asset	79,200	
Cr Deferred tax income		61,600
Cr Equity (separate component)		17,600
2) Recognition of deferred tax asset at 31 December 2006		
Dr Deferred tax asset	87,600	
Cr Deferred tax income		16,240
Cr Equity (separate component)		71,360
3) Derecognition of deferred tax asset at the vesting date		
Dr Equity (separate component)	88,960	
Dr Deferred tax expense	77,840	
Cr Deferred tax asset		166,800
4) Recognition of current income tax benefit at the vesting date		
Dr Current income tax receivable	368,720	
Cr Current tax income (profit or loss) (293,300 x 40%)		117,320
Cr Equity (share premium)		251,400

3. Share options – repricing

Wayne Holdings granted 100 *share options* to each of its 600 management-level *employees* at 1 January 2002, conditional upon the *employees* remaining employed by Wayne Holdings over a five-year period. The share price at *grant date* was €20. The exercise price is €25.

Wayne Holdings decides to reprice the options at 2 January 2005, at an exercise price of €10. At the repricing date, Wayne Holdings estimates that the *fair value* of the original award (before taking into account the repricing) is €1.50, and the *fair value* of the repriced award is €3. The incremental value is therefore €1.50. The repriced options will *vest* at the end of 2006.

Wayne Holdings has 500 *employees* left at the date of repricing and estimates that 440 *employees* will receive their *share options* at the end 2006. It estimates that 30 *employees* will leave in 2005, and that another 30 will leave in 2006. The actual number of leavers was 30 for 2005, and 28 for 2006.

The options are all exercised on 31 December 2007.

Step A: Obtain the key data needed to perform the calculations

Modification date	2 January 2005
Vesting date	31 December 2006
Share options per employee	100
Incremental fair value per option at the modification date	€1.50
Number of employees entitled to options	500
Estimated departures over a two-year period	60

Step B: Make an initial estimate of the total amount to be recorded

Compensation expense under the old arrangement (from 2002 through 2006):
Wayne Holdings is not required to apply IFRS 2 to the original grant, as the instruments were granted prior to 7 November 2002. However, it is required to apply IFRS 2 to the modification, as the repricing occurred after 1 January 2005.

Compensation expense for the incremental value arising from the repriced award (from 2005 through 2006):

Step	Result	Explanation
Total fair value of each award	€150	100 options at an incremental value of €1.50
Total number of awards expected to vest	440	500-60
Total compensation expense	**€66,000**	**440 x €150**

Step C: Determine the expense for each year and the corresponding journal entries

The compensation expense arising from the repricing, considering the revised estimates of the number of *employees* expected to leave, is determined as follows:

Year	Charge	Explanation
31 December 2005	€33,000	440 employees x €150 x 1/2
31 December 2006	€33,300	442 employees x €150 x 2/2 – €33,000
Total	**€66,300**	**442 employees x 150**

The journal entries are determined as follows:

(Amounts shown in euros)	**Dr**	**Cr**
1) Recognition of employee benefits expense for 2005		
Dr Employee benefits expense	33,000	
Cr Equity (separate component)		33,000
2) Recognition of employee benefits expense for 2006		
Dr Employee benefits expense	33,300	
Cr Equity (separate component)		33,300
3) Recognition of shares issued on exercise		
Dr Cash and cash equivalents	442,000	
Cr Equity (share capital) (44,200 shares at par value of €1 per share)		44,200
Cr Equity (share premium)		397,800
Dr Equity (separate component)	66,300	
Cr Equity (share premium)		66,300

Step D: Determine the tax adjustments

The tax legislation applicable to Wayne Holdings provides that the tax deduction relating to this equity-settled share-based payment transaction involving *share options* is based on the difference between the share price and the exercise price of an option at exercise date, which represents the *intrinsic value* for tax purposes. The information that will need to be gathered in order to determine the tax consequences of the compensation expense is overleaf.

	31 December 2005	31 December 2006 (vesting date)	31 December 2007 (exercise date)
Share price at each year end	€9	€15	€22
Exercise price	€10	€10	€10
Intrinsic value	€0	€5	€12
Number of options expected to vest (in hundreds)	440	442	442
Tax rate	40%	40%	40%
Compensation expense (cumulative)	€33,000	€66,300	€66,300
Tax benefit based on intrinsic value	–	€221,000 (442 x 100 x 5 x 2/2)	€530,400 (442 x 100 x 12)
Current tax receivable (40%)	–	–	€212,160
Deferred tax asset (40%)	–	€88,400	–
Change in deferred tax asset	–	€88,400	(€88,400)
Deferred tax:			
– recognised in the income statement	–	€26,520 (66,300 x 40%)	(€26,520)
– recognised in equity	–	€61,880 (88,400-26,520)	(€61,880)

The journal entries are determined as follows:

(Amounts shown in euros)	**Dr**	**Cr**
1) Recognition of deferred tax asset at 31 December 2005		
Dr Deferred tax asset	–	
Cr Deferred tax income		–
Cr Equity (separate component)		–
2) Recognition of deferred tax asset at 31 December 2006		
Dr Deferred tax asset	88,400	
Cr Deferred tax income		26,520
Cr Equity (separate component)		61,880
3) Derecognition of deferred tax asset on exercise		
Dr Equity (separate component)	61,880	
Dr Deferred tax expense	26,520	
Cr Deferred tax asset		88,400
4) Recognition of current tax receivable		
Dr Current tax receivable	212,160	
Cr Current tax income		26,520
Cr Equity (share premium)		185,640

4. Share appreciation rights

Wayne Holdings granted 10 share appreciation rights (SARs) to each member of a group of 40 management *employees* on 1 January 2004. The SARs provide the *employees*, at the date the rights are exercised, the right to receive cash equal to the appreciation in the entity's share price since the *grant date*. All of the rights *vest* on 31 December 2005. They can be exercised during 2006 and 2007. The entity estimates that at *grant date*, the *fair value* of each SAR granted is €11, and 10% of the *employees* will leave evenly during the two-year period. The *fair values* and *intrinsic values* are shown below. In 2006, six *employees* exercise the SARs at 31 December 2006; the remaining 30 *employees* exercise the SARs in 2007.

Date	Fair value	Intrinsic value
31 December 2004	€12	€10
31 December 2005	€8	€7
31 December 2006	€13	€10
31 December 2007	€12	€12

Intrinsic value equals *fair value* at the end of the life of a SAR because there is no time value.

Step A: Obtain the key data needed to perform the calculations

Grant date	1 January 2004
Vesting date	31 December 2005
SAR per employee	10
Fair value per SAR at grant date	€11
Number of employees entitled to SARs	40
Departure rate (evenly)	10%
Number of employees at 31 December 2004	38
Number of employees at 31 December 2005	36

Step B: Make initial estimate of the total amount to be recorded

This step is not applicable to cash-settled transactions.

Step C: Calculate the expense for each year and determine the corresponding journal entries

Year	Expense	Liability	Explanation
31 Dec 2004	€2,160	€2,160	36 employees x 10 SARs x €12 (fair value) x 50% (vesting period)
31 Dec 2005	€720	€2,880	36 employees x 10 SARs x €8 (fair value) x 100% (vesting period) The expense for 2005 is calculated by the difference between the fair value of the liability at 31 December 2004 and 31 December 2005.
31 Dec 2006	€1,620 (1,020+600)	€3,900	30 employees x 10 SARs x €13 (fair value). The expense for 2006 includes the cash paid to the six employees that exercised their options at 31 December 2006 (6 employees x 10 SARs x €10).
31 Dec 2007	(€300)	–	The liability is nil as all employees have exercised their SARs. The cash paid is €3,600 (30 x 10 x 12). The income is the difference between the liability at 31 December 2005 (€3,900) and the cash paid (€3,600).
Total	**€4,200**	**n/a**	

The journal entries are determined as follows:

(Amounts shown in euros)	**Dr**	**Cr**
1) Recognition of employee benefits expense in 2004		
Dr Employee benefits expense	2,160	
Cr Liability		2,160
2) Recognition of employee benefits expense in 2005		
Dr Employee benefits expense	720	
Cr Liability		720
3) Recognition of employee benefits expense in 2006		
Dr Employee benefits expense	1,620	
Cr Liability		1,620
4) To record the cash paid to six employees who exercised their options in 2006		
Dr Liability	600	
Cr Cash and cash equivalents		600
5) Employee benefits expense in 2007 and exercise of the share appreciation rights by the 30 employees.		
Dr Liability	3,900	
Cr Employee benefits expense		300
Cr Cash and cash equivalents		3,600

Step D: Determine the tax adjustments

The tax legislation applicable to Wayne Holdings provides that the tax deduction relating to a cash-settled share-based payment transaction involving SARs is based on the *intrinsic value* for tax purposes. The *intrinsic value* for tax purposes was determined as follows:

Date	Intrinsic value
31 December 2004	€10
31 December 2005	€7
31 December 2006	€10
31 December 2007	€12

The tax consequences of the SARs would then be determined as follows:

	31 December 2004	31 December 2005	31 December 2006	31 December 2007
Intrinsic value	€10	€7	€10	€12
Number of SARs expected to vest or outstanding after vesting	360	360	300	0
Tax rate	40%	40%	40%	40%
Vesting	50%	100%	100%	100%
Deferred tax asset	€720 (360 x 10 x 40%x 50%)	€1,008 (360 x 7 x 40% x 100%)	€1,200 (300 x 10 x 40% x 100%)	–
Current income tax receivable	–	–	€240 (60 x €10 x 40%)	€1,440 (300 x €12 x 40%)
Changes in deferred tax asset	€720	€288	€192	(€1,200)
Tax recognised in the income statement (current and deferred)	€720	€288	€432	€240

The journal entries would be determined as follows:

(Amounts shown in euros)	**Dr**	**Cr**
1) Recognition of deferred tax asset at 31 December 2004		
Dr Deferred tax asset	720	
Cr Deferred tax income		720
2) Recognition of deferred tax asset at 31 December 2005		
Dr Deferred tax asset	288	
Cr Deferred tax income		288
3) Recognition of deferred tax asset at 31 December 2006		
Dr Deferred tax asset	192	
Cr Deferred tax income		192
4) Recognition of current tax benefit at 31 December 2006		
Dr Current tax receivable	240	
Cr Current tax income (profit and loss)		240
5) Derecognition of deferred tax asset at 31 December 2007		
Dr Deferred tax expense	1,200	
Cr Deferred tax asset		1,200
6) Recognition of current income tax benefit at 31 December 2007		
Dr Current tax receivable	1,440	
Cr Current tax income (profit or loss)		1,440

5. Transactions with settlement alternatives

At 1 January 2005, Wayne Holdings grants its CEO the right to choose either 1,000 phantom shares (ie, the right to receive a cash payment equal to the value of 1,000 shares) or 1,500 shares. The grant is conditional upon the completion of two years of service. If the CEO chooses the share alternative, he must keep the shares for a period of five years. The share price is as follows:

Date	Fair value
1 January 2005	€7
31 December 2005	€9
31 December 2006	€15
31 December 2007	€22

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 €6.50 per share.

Step A: Obtain the key data needed to perform the calculations

Grant date	1 January 2005
Vesting date	31 December 2006
Fair value of share alternative at grant date	€6.50

Step B: Make the initial estimate of the total amounts to be recorded

Calculate the *fair values* of the equity and debt alternatives.

Alternatives	Fair value	Calculation
Equity alternative	€9,750	1,500 x €6.50
Cash alternative	€7,000	1,000 x €7

The *fair value* of the equity component of the compound financial instrument is therefore €2,750.

Step C: Determine the expense for each year and the corresponding journal entries

The CEO exercises his cash option at the end of 2006. The equity and liability components to be recorded in 2005 and 2006 are determined as follows:

Year ended	Expense	Liability	Equity	Explanation
31 December 2005	€4,500	€4,500		1,000 x €9 x 1/2
31 December 2005	€1,375		€1,375	€2,750 x 1/2
31 December 2006	€10,500	€10,500		(1,000 x €15)-4,500
31 December 2006	€1,375		€1,375	€2,750 x 1/2
Total	**€17,750**	**€15,000**	**€2,750**	

The journal entries are determined as follows:

(Amounts shown in euros)	Dr	Cr
1) Recognition of employee benefits expense in 2005		
Dr Employee benefits expense	5,875	
Cr Liability		4,500
Cr Equity (separate component)		1,375
2) Recognition of employee benefits expense in 2006		
Dr Employee benefits expense	11,875	
Cr Liability		10,500
Cr Equity (separate component)		1,375
3) Settlement of the phantom shares		
Dr Liability	15,000	
Cr Cash and cash equivalents		15,000
Dr Equity (separate component)	2,750	
Cr Equity (retained earnings)		2,750

Step D: Determine the tax adjustments

The tax legislation applicable to Wayne Holdings provides that the tax deduction relating to an arrangement with settlement alternatives is based on the share price at the date of settlement for the phantom shares.

The tax consequences of the arrangement would be determined as follows:

Year ended	31 December 2005	31 December 2006
Share price	€9	€15
Number of SARs outstanding at each year end	1,000	1,000
Tax rate	40%	40%
Vesting	50%	100%
Deferred tax asset	€1,800 (1,000 x €9 x 40%) x 50%	–
Current income tax receivable	–	€6,000 (1,000 x €15 x 40%) x 100%
Tax recognised in the income statement (current and deferred)	€1,800	€4,200

The journal entries would be determined as follows:

(Amounts shown in euros)	**Dr**	**Cr**
1) Recognition of deferred tax asset at 31 December 2005		
Dr Deferred tax asset	1,800	
Cr Deferred tax income		1,800
2) Derecognition of the deferred tax asset at 31 December 2006		
Dr Deferred tax expense	1,800	
Cr Deferred tax asset		1,800
3) Recognition of current tax benefit at 31 December 2006		
Dr Current tax receivable	6,000	
Cr Current tax income (profit and loss)		6,000

6. ‘Save as you earn’ schemes

500 Wayne Holdings *employees* participate in a share purchase plan on the following terms:

- *Employees* invest a fixed amount of €100 per month in a savings plan, operated by an independent investment manager, by deductions from their pay for a period of three years from 1 April 2005.
- The savings plan provides a fixed return of 10% of the final invested amount at the end of three years. This return is guaranteed by the investment manager operating the savings plan and has no cost to the employer. Each *employee* will have accumulated savings of €3,960 after three years (€100 x 36 months, ie €3,600, plus 10% return = €3,960).
- In addition to the 10% return, *employees* will receive options with an exercise price of €6 if they remain *employees*. Each *employee* will therefore use the saved amount to acquire 660 shares (€3,960/€6 = 660 shares).
- At the end of the savings period, *employees* have a six-month exercise window.

Step A: Obtain the key data needed to perform the calculations

Grant date	1 April 2005
Vesting date	31 March 2008
Options per employee	660
Fair value per option at grant date	€4
Number of employees entitled to options	500
Exercise price	€6
Share price at grant date	€8
Departures (estimated at grant date)	50

Step B: Make an initial estimate of the total amounts to be recorded

Step	Result	Explanation
Total fair value of one award	€2,640	660 options x €4
Total number of awards expected to vest	450	500-50
Total compensation expense	**€1,188,000**	**450 x €2,640**

Step C: Determine the expense for each year and the corresponding journal entries

At *grant date*, Wayne Holdings expected that 50 *employees* would leave the company during the *vesting period*. This estimate was not revised during the *vesting period*, as the number of *employees* leaving during 2005, 2006 and 2007 was in line with expectations. In 2008, more *employees* left the company than expected, and by 1 April 2008, 120 of the 500 *employees* had either left the company or stopped their saving and therefore forfeited their option rights.

As a result, 380 *employees vested* their options at the end of March 2008. These options are exercised on 5 April 2008, and Wayne Holdings issues shares with a par value of €1 to its *employees*.

The employee benefits expense is as follows:

Period ended	Expense	Explanation
31 December 2005	€297,000	€2,640 x 450 x 9/36
31 December 2006	€396,000	€2,640 x 450 x 12/36
31 December 2007	€396,000	€2,640 x 450 x 12/36
31 March 2008	(€85,800)	€2,640 x 380 less expense recognised in 2005 to 2007 This is the adjustment for actual forfeitures at end March 2008
Total	**€1,003,200**	**380 employees x €2,640**

The journal entries are as follows:

(Amounts shown in euros)	**Dr**	**Cr**
1) Recognition of employee benefits expense in 2005		
Dr Employee benefits expense	297,000	
Cr Equity (separate component)		297,000
2) Recognition of employee benefits expense in 2006		
Dr Employee benefits expense	396,000	
Cr Equity (separate component)		396,000
3) Recognition of employee benefits expense in 2007		
Dr Employee benefits expense	396,000	
Cr Equity (separate component)		396,000
4) Employee benefits expense, including adjustment for actual forfeitures		
Dr Equity (separate component)	85,800	
Cr Employee benefits expense		85,800
3) Recognition of shares issued to employees at exercise price		
Dr Cash and cash equivalents	1,504,800	
Cr Equity (share capital)		250,800
Cr Equity (share premium)		1,254,000
Dr Equity (separate component)	1,003,200	
Cr Equity (share premium)		1,003,200

Step D: Determine the tax adjustments

The tax legislation applicable to Wayne Holdings provides that the tax deduction relating to an equity-settled share-based payment transaction involving *share options* is based on the difference between the share price and the exercise price of an option at exercise date, which represents the *intrinsic value* for tax purposes. In order to determine the tax consequences of accounting for the expense, the following information will need to be gathered:

	1 April 2005 (grant date)	31 December 2005	31 December 2006	31 December 2007	5 April 2008 (exercise date)
Share price	€7	€9	€15	€22	€20
Exercise price	€6	€6	€6	€6	€6
Intrinsic value	€1	€3	€9	€16	€14
Number of options expected to vest	297,000	297,000	297,000	297,000	250,800
Tax rate	40%	40%	40%	40%	40%
Compensation expense (cumulative)	–	€297,000	€693,000	€1,089,000	€1,003,200
Benefit based on intrinsic value		€222,750 (3 x 297,000 x 9/36)	€1,559,250 (9 x 297,000 x 21/36)	€4,356,000 (16 x 297,000 x 33/36)	€3,511,200 (250,800 x 14)
Deferred tax asset (at 40%)	–	€89,100	€623,700	€1,742,400	–
Current tax asset (40%)	–	–	–	–	€1,404,480
Current tax:					
– recognised in profit and loss	–	–	–	–	€401,280 (1,003,200 x 40%)
– recognised in equity	–	–	–		€1,003,200
Change in deferred tax asset	–	€89,100	€534,600	€1,118,700	(€1,742,400)
Deferred tax:					
– recognised in profit and loss	–	€89,100	€188,100 (693,000 x 40%-89,100)	€158,400 (1,089,000 x 40%-89,100-188,100)	(€435,600)
– recognised in equity	–	–	€346,500	€960,300	(€1,306,800)

The journal entries are determined as follows:

(Amounts shown in euros)	**Dr**	**Cr**
1) Recognition of deferred tax asset at 31 December 2005		
Dr Deferred tax asset	89,100	
Cr Deferred tax income		89,100
2) Recognition of the deferred tax asset at 31 December 2006		
Dr Deferred tax asset	534,600	
Cr Deferred tax income		188,100
Cr Equity (separate component)		346,500
3) Recognition of the deferred tax asset at 31 December 2007		
Dr Deferred tax asset	1,118,700	
Cr Deferred tax income		158,400
Cr Equity (separate component)		960,300
4) Derecognition of the deferred tax asset at exercise date		
Dr Deferred tax expense	435,600	
Dr Equity (separate component)	1,306,800	
Cr Deferred tax asset		1,742,400
5) Recognition of current tax benefit at exercise date		
Dr Current tax receivable	1,404,480	
Cr Equity (share premium)		1,003,200
Cr Current tax income (profit and loss)		401,280

7. In-kind capital contributions

Wayne Holdings issued 100,000 shares in exchange for a capital contribution of an office building. The ownership of the building was transferred to Wayne Holdings on 15 January 2005 when the shares were issued. The *fair value* of the building on that date was €5,500,000.

Step A: Obtain the key data needed to perform the calculations

Date the goods or services were obtained	15 January 2005
Vesting	100%
Valuation report showing fair value of the building	€5,500,000

Step B: Make an initial estimate of the total amounts to be recorded

The fair value of the building was determined to be €5,500,000 based on a report prepared by a professional valuer.

Step C: Determine the journal entries

The journal entries are determined as follows:

(Amounts shown in euros)	**Dr**	**Cr**
1) Recognition of Property, plant and equipment at 15 January 2005		
Dr Property, plant and equipment	5,500,000	
Cr Equity (share premium)		5,400,000
Cr Equity (share capital) (at par value of €1 per share)		100,000

Step D: Determine the tax adjustments

The tax legislation applicable to Wayne Holdings provides that the tax deduction is equal to depreciation of the building charged for accounting purposes over its useful life of 10 years. The tax consequences for 2005 and following years would be determined as follows (amounts expressed in thousands):

	31 December 2005	31 December 2006	Following years
Carrying value of the building	€4,950	€4,400	–
Tax base of the building	€4,950	€4,400	–
Tax rate	40%	40%	40%
Vesting	100%	100%	100%
Current income tax received/receivable	€220 (5,500/10 x 40%) x 100%	€440	€2,200
Tax recognised in the income statement	€220	€220	€1,760

The journal entries would be determined as follows:

(Amounts shown in euros)	**Dr**	**Cr**
1) Recognition of current tax benefit at 31 December 2005		
Dr Current tax receivable	220,000	
Cr Current tax income (profit or loss)		220,000
2) Recognition of current tax benefit at 31 December 2006		
Dr Current tax receivable	220,000	
Cr Current tax income (profit or loss)		220,000
3) Recognition of current tax benefit rateably over the period of 2007 to 2014		
Dr Current tax receivable	1,760,000	
Cr Current tax income (profit or loss)		1,760,000

8. Shares for services

Wayne Holdings is establishing a media business and has hired a marketing agency to provide consultancy services. The services will be settled by issuing 50,000 shares.

Step A: Obtain the key data needed to perform the calculations

Period over which the service is provided	1 January to 28 February 2005
Fair value of the service	€400,000

Fair value of the service was determined based on bids submitted by other marketing agencies to provide the consulting services.

Step B: Make an initial estimate of the total amount to be recorded at the grant date

The total amount to be recorded is the service's *fair value* of €400,000.

Step C: Determine the expense for each period and the corresponding journal entries

Period	Expense	Equity	Explanation
31 January 2005	€200,000	€200,000	€400,000 x 50%
28 February 2005	€200,000	€200,000	€400,000 x 100%-€200,000
Total	**€400,000**	**€400,000**	

The journal entries are determined as follows:

(Amounts shown in euros)	**Dr**	**Cr**
1) Recognition of the services rendered in January 2005		
Dr Operating expenses	200,000	
Cr Equity (separate component)		200,000
2) Recognition of the services for February 2005		
Dr Operating expenses	200,000	
Cr Equity (separate component)		200,000
3) Issuance of shares		
Dr Equity (separate component)	400,000	
Cr Equity (share premium)		350,000
Cr Equity (share capital, at par value €1 per share)		50,000

Step D: Determine the tax adjustments

The tax legislation applicable to Wayne Holdings provides that there is no tax deduction for non-cash costs incurred in connection with consultancy services settled by issuing shares. No tax effects are recognised as a result.

Illustrative disclosures

This section provides examples of the disclosures required under IFRS 2. For illustration purposes, we have included disclosures for all of the examples included in this section.

Accounting policy

Wayne Holdings regularly enters into equity-settled or cash-settled share-based payment transactions with *employees* and other third parties.

- **Employee services settled in equity instruments**
  The *fair value* of the employee services received in exchange for the grant of options or shares is recognised as an expense. The total amount to be expensed rateably over the *vesting period* is determined by reference to the *fair value* of the options or shares determined at the *grant date*, excluding the impact of any non-market *vesting conditions* (for example, profitability and sales growth targets). Non-market *vesting conditions* are included in assumptions about the number of options that are expected to become exercisable or the number of shares that the *employee* will ultimately receive. This estimate is revised at each balance sheet date and the difference is charged or credited to the income statement, with a corresponding adjustment to equity. The proceeds received on exercise of the options net of any directly attributable transaction costs are credited to equity.

- **Other goods or services settled in equity instruments**
  Goods or services (other than employee services) received in exchange for an equity-settled share-based payment are measured directly at their *fair value* and are recognised as an expense when consumed or capitalised as assets. The proceeds received on exercise of the options, net of any directly attributable transaction costs, are credited to share capital (nominal value) and share premium when the options are exercised.

- **Goods or services settled in cash**
  Goods or services, including employee services received in exchange for cash-settled share-based payments, are recognised at the *fair value* of the liability incurred and are expensed when consumed or capitalised as assets, which are depreciated or amortised. The liability is remeasured at each balance sheet date to its *fair value*, with all changes recognised immediately in profit or loss.

Share-based payment arrangements – disclosures in the notes

During the period ended 31 December 2005, Wayne Holdings had six share-based payment arrangements with *employees* and entered into two other share-based transactions. The details of the arrangements are described on this and the following pages.

Arrangement	1: Share options granted to key executives	2: Performance conditions – increase in earnings	3: Share options – repricing
Nature of the arrangement	Grant of share options	Grant of shares	Grant of share options
Date of grant	1 January 2005	1 January 2005	1 January 2002
Number of instruments granted	1,000	50,000	50,000[1]
Exercise price	€3	n/a	€25 (repriced at €10 at 2 January 2005)
Share price at the date of grant	€7	€7	€20
Contractual life (years)	10	10	10
Vesting conditions	Three years of service and 18% increase in share price by end of 2007	Variable vesting based on the achievement of non-market-based performance conditions	Five-year service period (two years remaining after repricing)
Settlement	Shares	Shares	Shares
Expected volatility	40%	n/a	40%
Expected option life at grant date (years)	4	n/a	4[2]
Risk-free interest rate	4.8%	n/a	4.8%
Expected dividend (dividend yield)	0%	0%	0%
Expected departures (grant date)	0%	30 departures/year	30 departures/ year after 2004
Expected outcome of meeting performance criteria (at the grant date)	n/a (allowed for in determining fair value)	100% by 2006	n/a
Fair value per granted instrument determined at the grant date	€5	€7	Incremental value from repricing is €1.5
Valuation model	Monte-Carlo model	n/a	Binomial model

The entity uses a *Black-Scholes model* to value options with no *vesting conditions* other than time less there is an extended exercise period. It uses the *Monte-Carlo* or *Binomial models* to value options with performance conditions. The expected *volatility* for the *share option* arrangements is based on historical *volatility* determined by the analysis of daily share price movements over the past three years.

[1] The entity originally granted 60,000 options on 1 January 2002. The options were repriced at 2 January 2005 when the number of outstanding options was 50,000.

[2] The expected life of the option at grant date (1 January 2002) was seven years. At the date of modification (2 January 2005), the expected remaining life was estimated at four years.

Arrangement	4: Share appreciation rights	5: A transaction with settlement alternatives	6: Save as you earn scheme
Nature of the arrangement	Share appreciation rights	Arrangement with a settlement alternative	'Save as you earn' scheme
Date of grant	1 January 2004	1 January 2005	1 April 2005
Number of instruments granted	400	1,000 (cash) -1,500 (shares)	330,000
Exercise price	n/a	n/a	€6
Share price at the date of grant	€15	€7	€8
Contractual life (years)	4	10	3.5
Vesting conditions	Two-year service period	Two-year service period	Three-year service period and savings requirement
Settlement	Cash	Cash or shares	Shares
Expected volatility	40%	40%	40%
Expected option life at grant date (years)	4	3	3.2
Risk-free interest rate	4.8%	4.8%	4.8%
Expected dividend (dividend yield)	0%	0%	0%
Expected departures (grant date)	10% evenly over two-year period	0%	50 over 3 years
Expected outcome of meeting performance criteria (at the grant date)	n/a	n/a	n/a
Fair value per granted instrument determined at the grant date	€11	Fair value of share alternative €6.5; Fair value of cash alternative €7	€4
Valuation model	Black-Scholes	Binomial model	Black-Scholes

No *share options* were exercised during the period. The following information applies to options outstanding at the end of each period:

	31 December 2005				31 December 2004			
Range of exercise prices	Weighted average exercise price	Number of options ('000)	Weighted average remaining life		Weighted average exercise price	Number of shares ('000)	Weighted average remaining life	
			Expected	Contractual			Expected	Contractual
€15-27	€25	–	–	–	€25	50,000	1.8	7.3
€8-15	€10	47,000	2.2	7.7	–	–	–	–
€5-8	€6	321,420	2.45	2.75	–	–	–	–
€0-5	€3	1,000	3.3	9.3	–	–	–	–

A reconciliation of movements in the number of *share options* (Arrangement 1 – 'Share options granted to key executives', Arrangement 3 – 'Share-options – repricing,' and Arrangement 6 – 'Save as you earn scheme') can be summarised as follows:

	2005		2004	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Outstanding at start of year	50,000	€25	50,000	€25
Effect of modifications and cancellations	(50,000)	€25	–	–
Granted	381,000[1]	€6.5	–	–
Forfeited	(11,580)	€7	–	–
Exercised	–	–	–	–
Outstanding at end of year	369,420	€6.5	50,000	€25
Exercisable at year-end	–	–	–	–

The amounts recognised in the financial statements (before taxes) for share-based payment transactions with *employees* can be summarised as follows:

Expense	2005	2004
Equity-settled arrangements		
a) Share options granted to key executives	€1,667	–
b) Performance conditions – an increase in earnings	€154,000	–
c) Repriced share options	€33,000	–
d) 'Save as you earn' scheme	€297,000	–
Sub-total	€485,667	–
Cash-settled arrangements		
e) Share appreciation rights	€720	€2,160
Arrangements with settlement alternatives		
f) Transactions with settlement alternatives	€5,875	–
Total expense	**€492,262**	**€2,160**

Liability for cash-settled arrangements	31 December 2005	31 December 2004
a) Share appreciation rights	€2,880	€2,160
b) Transactions with settlement alternatives	€4,500	–
Total liability	**€7,380**	**€2,160**

[1] Wayne Holdings also granted the CEO a compound financial instrument, giving the CEO the right to receive 1,500 shares subject to a five-year holding restriction or a cash payment equivalent to the value of 1,000 shares.

The *fair value* of the shares for the arrangements in which shares are granted was based on the quoted share price. No dividend payments were expected; consequently, the measurement of the options' *fair value* did not consider dividends.

Share options granted in 2002 were repriced at 2 January 2005 due to the decrease in share price. The exercise price at 2 January 2005 is €10 instead of the original exercise price of €25. The incremental value as a result of the repricing was determined to be €1.50.

All of the rights arising from Arrangement 4 – 'Share appreciation rights', are fully *vested* at 31 December 2005. The *intrinsic value* of these rights is €7 (for each right).

In addition to the arrangements described above, the entity issued 100,000 shares on 15 January 2005 in exchange for an in-kind contribution of an office building with a *fair value* of €5,500,000. The fair value was based on a report prepared by an independent professional valuer. The entity also issued 50,000 shares in exchange for consulting services recognised as an expense and a corresponding increase in equity at a *fair value* of €400,000. The *fair value* of the service was determined based on bids submitted by other potential suppliers.

Appendix A – Valuation considerations

Gathering the required information

The *fair value* of a *share option* is determined using valuation models when market prices are not available. The commonly used models are the *Black-Scholes model,* the *Binomial model* and the *Monte-Carlo* model. These are described in the Glossary on p52. All these models are derived from the same underlying theories. However, they vary in the extent to which it is possible to reflect the specific terms of a particular award or variations in the assumptions.

The choice of modelling approach will be influenced by the details of the award. The *Black-Scholes model* will generally be appropriate for a simple option that has a three-year service vesting period and a six-month exercise period. The *Binomial model* is an extension of the *Black-Scholes model* and allows for an extended exercise window. The *Monte-Carlo model* may be the only way to value a complex option with, for example, a 10-year contractual term and *market conditions* for a newly listed company that expects share price *volatility* to be high following the IPO and then to reduce.

Most modelling approaches will need consideration of at least the following parameters:

- **Share price at grant date:** the market value of shares should be easy to ascertain if the share is traded. However, this may require some effort for unlisted entities. A value will be needed for tax purposes in most jurisdictions but that may not always be *fair value*.
- **Exercise price:** this should be clearly identifiable from the terms of the award. If it is not, it is unlikely that the parties to the award can be considered to have a 'shared understanding of the terms'. This would mean the *grant date* has not yet been established.
- **Share price volatility:** a history of market prices will provide evidence of historical *volatility* for actively traded shares, but does that provide a reasonable guide to the future? What special events may have distorted that history? For other shares without a trading record, a comparator group or a sector-specific index may provide an indication. How you choose a comparator or index will be a matter of judgement, but market data should be taken into account wherever possible.
- **The risk-free rate of return:** this should be based on zero-coupon government-bond yields of appropriate duration, which should be available from market indicators.
- **The expected dividends:** these can influence the value of awards, depending on how they will be treated. For example, for an option, dividends are effectively 'lost' until exercise; for some forms of share awards, they are reinvested. Is the assumption consistent with any policy or forecasts given to markets? Could the assumption that is subject to stock-exchange regulations be considered a forecast by markets?
- **Performance conditions:** what are the possible outcomes? How can the likelihood of these possible outcomes be evaluated? What data are the performance conditions measured on?
- **Expected life:** the factors relevant to determining the expected life of an option are the contractual term, the possibility of an early exercise, and whether the option can be traded.

  The majority of *employee* options cannot be traded, so an *employee* only has the choice of either keeping or exercising the option. Exercising is the only way in which value can be realised. This means that most employee *share options* are exercised much earlier than their contractual term. As the value of an option is related to its duration, management needs to estimate how long that will be. This will be straightforward for some types of arrangement, as they have a limited exercise window. But this will be complex for many other types of arrangement, as *employees* may be able to exercise at any time between, for example, the third and 10th anniversary of the grant.

Factors to consider include: what has past experience been? Have *employees* exercised as soon as possible or held on to their options for as long as possible? What factors might influence the *employees'* choices? Some examples of factors that may influence employee behaviour are:

- **The intrinsic value of the option:** *employees* might exercise their options once a certain level of gain has been reached, either in absolute or percentage terms.
- **General state of the equity market:** if markets are generally climbing, *employees* might be more inclined to hold on to their options as long as possible. If markets are performing poorly, *employees* might decide to exercise as soon as they see a gain.
- **The dividend yield on the share:** when the share does not pay a dividend, the option holder does not lose anything by not exercising the option. For a dividend-paying share, the option holder is forgoing the dividends that exceed the risk-free rate of return on the cash that would be used to fund the exercise price of the options.
- **Tax treatment of the benefits:** this can vary significantly between territories. If a tax charge crystallises on vesting, employees may have to exercise to meet their tax liability.

  Entities may find gathering the required information and tracking the awarded instruments a challenge, as there may have been less need for the information in the past and data may not have been kept in a form that permits the necessary detail to be extracted. The complexity of data gathering depends on the extent and complexity of awards and the availability of records that track the awarded instruments in the required form.

Appendix B – Glossary

Binomial model

The Binomial model is an extension of the *Black-Scholes model*, allowing for the facility to exercise options within a window. It is a numerical technique that will exactly reproduce the results of the *Black-Scholes* formula for an option that can only be exercised at the end of its term. The Binomial model has a number of limitations in relation to executive options:

- It is difficult to allow for performance conditions, turnover or exercise patterns in a Binomial model; and
- The Binomial model is not valid for executive options because in most cases the model assumes that the option will be sold rather than exercised. Early exercise is deemed to occur only in a few scenarios. An executive option cannot be sold in this way, so the Binomial model is not an appropriate way for dealing with early exerciseability of executive options.

Black-Scholes model

The Black-Scholes valuation model is a mathematical formula used to calculate the value of a European call option based on the underlying share price, exercise price, expiration date, risk-free rate of return, and the standard deviation (*volatility*) of the share price returns. A European call option can only be exercised at the end of its life, unlike an American call option, which can be exercised at any time during its life. The model is also referred to as the Black-Scholes-Merton formula for pricing an option.

The Black-Scholes model has limitations. These are that performance conditions are not allowed for; and the option is assumed to be exercised at the end of a fixed term.

Employees and others providing similar services

Individuals who render personal services to the entity and either (a) the individuals are regarded as employees for legal or tax purposes, (b) the individuals work for the entity under its direction in the same way as individuals who are regarded as employees for legal or tax purposes, or (c) the services rendered are similar to those rendered by employees. The term encompasses all management personnel – ie, those persons having authority and responsibility for planning, directing and controlling the activities of the entity, including non-executive directors.

Equity instrument

A contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.

Fair value

The amount for which an asset or an *equity instrument* granted could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Grant date

The date at which the entity and another party (including an *employee*) agree to a share-based payment arrangement, being when the entity and the counterparty have a shared understanding of the terms and conditions of the arrangement. At *grant date*, the entity confers on the counterparty the right to cash, other assets, or *equity instruments* of the entity, provided the specified *vesting conditions*, if any, are met. If that agreement is subject to an approval process (for example, by shareholders), *grant date* is the date when that approval is obtained.

Intrinsic value

The difference between the *fair value* of shares and the price (if any) that a counterparty is (or will be) required to pay for those shares.

Market condition

A condition upon which the exercise price, *vesting* or exercisability of an *equity instrument* depends and that is related to the market price of the entity's *equity instruments*. This includes attaining a specified share price or a specified amount of *intrinsic value* of a *share option*, and achieving a specified target that is based on the market price of the entity's *equity instruments* relative to an index of market prices of *equity instruments* of other entities.

Monte-Carlo model

The Monte-Carlo valuation model works by undertaking several thousand simulations of future outcomes for share price and other variables, calculating the option pay-out under each scenario, taking the average pay-out and discounting to the present day to give an option value.

Monte-Carlo models can incorporate even very complex performance conditions, turnover and exercise patterns that are a function of gain or time since grant. These models are generally the best type of model for valuing executive options.

The main disadvantages of Monte-Carlo models are the complexity and the computing power required.

Share option

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

Vest

The point at which the holder obtains an entitlement. Under a share-based payment arrangement, a counterparty's right to receive cash, other assets, or *equity instruments* of the entity vests upon satisfaction of any specified *vesting conditions*.

Vesting conditions

The conditions that must be satisfied for the counterparty to become entitled to receive cash, other assets or *equity instruments* of the entity, under a share-based payment arrangement. Vesting conditions include service conditions, which require the other party to complete a specified period of service, and performance conditions, which require specified performance targets to be met (such as a specified increase in the entity's profit over a specified period of time).

Vesting period

The period during which all the specified *vesting conditions* of a share-based payment arrangement are to be satisfied.

Volatility

A statistical measure of the fluctuation in the investment return on a share.

Notes

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PricewaterhouseCoopers has a range of tools and publications to help companies apply IFRS (see also the inside front cover).

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