

**Compiled Accounting Standard**

**AASB 2**

# **Share-based Payment**

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This compiled Standard applies to annual reporting periods beginning on or after 1 July 2007. Early application is permitted. It incorporates relevant amendments made up to and including 28 June 2007.

Prepared on 19 October 2007 by the staff of the Australian Accounting Standards Board.



**Australian Government**

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BASIS FOR CONCLUSIONS ON IFRS 2

(available on the AASB website)

Australian Accounting Standard AASB 2 *Share-based Payment* (as amended) is set out in paragraphs 1 – 59 and Appendices A – B. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. Terms defined in this Standard are in *italics* the first time they appear in the Standard. AASB 2 is to be read in the context of other Australian Accounting Standards, including AASB 1048 *Interpretation and Application of Standards*, which identifies the Australian Accounting Interpretations. In the absence of explicit guidance, AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies.

## COMPILATION DETAILS

### Accounting Standard AASB 2 *Share-based Payment* as amended

This compiled Standard applies to annual reporting periods beginning on or after 1 July 2007. It takes into account amendments up to and including 28 June 2007 and was prepared on 19 October 2007 by the staff of the Australian Accounting Standards Board (AASB).

This compilation is not a separate Accounting Standard made by the AASB. Instead, it is a representation of AASB 2 (July 2004) as amended by other Accounting Standards, which are listed in the Table below.

**Table of Standards**

Standard	Date made	Application date (annual reporting periods ... on or after ...)	Application, saving or transitional provisions
AASB 2	15 Jul 2004	(beginning) 1 Jan 2005	
AASB 2007-1	15 Feb 2007	(beginning) 1 Mar 2007	see (a) below
AASB 2007-4	30 Apr 2007	(beginning) 1 Jul 2007	see (b) below
AASB 2007-7	28 Jun 2007	(beginning) 1 Jul 2007	see (b) below
AASB 2007-8	24 Sep 2007	(beginning) 1 Jan 2009	not compiled*

\* The amendments made by this Standard are not included in this compilation, which presents the principal Standard as applicable to annual reporting periods beginning on or after 1 July 2007.

- (a) Entities may elect to apply this Standard to annual reporting periods beginning on or after 1 January 2005 but before 1 March 2007. If an entity applies AASB Interpretation 11 *AASB 2 – Group and Treasury Share Transactions* to such an annual reporting period, this Standard shall also be applied to that period.
- (b) Entities may elect to apply this Standard to annual reporting periods beginning on or after 1 January 2005 but before 1 July 2007.

**Table of Amendments to Standard**

Paragraph affected	How affected	By ... [paragraph]
Aus52.1	added	AASB 2007-1 [5]
53-59	added	AASB 2007-1 [5]

**Table of Amendments to Implementation Guidance**

<b>Paragraph affected</b>	<b>How affected</b>	<b>By ... [paragraph]</b>
IG8	amended	AASB 2007-7 [8]
IG12	amended	AASB 2007-4 [18]

## **COMPARISON WITH INTERNATIONAL PRONOUNCEMENTS**

### **AASB 2 and IFRS 2**

AASB 2 as amended is equivalent to IFRS 2 *Share-based Payment* as issued and amended by the IASB.

Paragraphs that have been added to this Standard (and do not appear in the text of the equivalent IASB Standard) are identified with the prefix “Aus”, followed by the number of the relevant IASB paragraph and decimal numbering.

### **Compliance with IFRS 2**

Entities that comply with AASB 2 as amended will simultaneously be in compliance with IFRS 2 as amended.

### **AASB 2 and IPSASs**

International Public Sector Accounting Standards (IPSASs) are issued by the International Public Sector Accounting Standards Board of the International Federation of Accountants.

There is no IPSAS dealing with share-based payment at present.

## ACCOUNTING STANDARD AASB 2

The Australian Accounting Standards Board made Accounting Standard AASB 2 *Share-based Payment* under section 334 of the *Corporations Act 2001* on 15 July 2004.

This compiled version of AASB 2 applies to annual reporting periods beginning on or after 1 July 2007. It incorporates relevant amendments contained in other AASB Standards made by the AASB up to and including 28 June 2007 (see Compilation Details).

## ACCOUNTING STANDARD AASB 2

### *SHARE-BASED PAYMENT*

#### Objective

- 1 The objective of this Standard is to specify the financial reporting by an entity when it undertakes a *share-based payment transaction*. In particular, it requires an entity to reflect in its profit or loss and financial position the effects of share-based payment transactions, including expenses associated with transactions in which *share options* are granted to employees.

#### Application

**Aus1.1 This Standard applies to:**

- (a) each entity that is required to prepare financial reports in accordance with Part 2M.3 of the Corporations Act and that is a reporting entity;
- (b) general purpose financial reports of each other reporting entity; and
- (c) financial reports that are, or are held out to be, general purpose financial reports.

**Aus1.2 This Standard applies to annual reporting periods beginning on or after 1 January 2005.**

[Note: For application dates of paragraphs changed or added by an amending Standard, see Compilation Details.]



- Aus1.3**      **This Standard shall not be applied to annual reporting periods beginning before 1 January 2005.**
- Aus1.4**      **The requirements specified in this Standard apply to the financial report where information resulting from their application is material in accordance with AASB 1031 *Materiality*.**
- Aus1.5      Notice of this Standard was published in the *Commonwealth of Australia Gazette* No S 294, 22 July 2004.

## **Scope**

- 2      An entity shall apply this Standard in accounting for all share-based payment transactions including:
- (a)   *equity-settled share-based payment transactions*, in which the entity receives goods or services as consideration for *equity instruments* of the entity (including shares or share options);
  - (b)   *cash-settled share-based payment transactions*, in which the entity acquires goods or services by incurring liabilities to the supplier of those goods or services for amounts that are based on the price (or value) of the entity's shares or other equity instruments of the entity; and
  - (c)   transactions in which the entity receives or acquires goods or services and the terms of the arrangement provide either the entity or the supplier of those goods or services with a choice of whether the entity settles the transaction in cash (or other assets) or by issuing equity instruments,
- except as noted in paragraphs 5 and 6.
- 3      For the purposes of this Standard, transfers of an entity's equity instruments by its shareholders to parties that have supplied goods or services to the entity (including employees) are share-based payment transactions, unless the transfer is clearly for a purpose other than payment for goods or services supplied to the entity. This also applies to transfers of equity instruments of the entity's parent, or equity instruments of another entity in the same group as the entity, to parties that have supplied goods or services to the entity.
- 4      For the purposes of this Standard, a transaction with an employee (or other party) in his/her capacity as a holder of equity instruments of the entity is not a share-based payment transaction. For example, if an

entity grants all holders of a particular class of its equity instruments the right to acquire additional equity instruments of the entity at a price that is less than the *fair value* of those equity instruments, and an employee receives such a right because he/she is a holder of equity instruments of that particular class, the granting or exercise of that right is not subject to the requirements of this Standard.

- 5 As noted in paragraph 2, this Standard applies to share-based payment transactions in which an entity acquires or receives goods or services. Goods includes inventories, consumables, property, plant and equipment, intangible assets and other non-financial assets. However, an entity shall not apply this Standard to transactions in which the entity acquires goods as part of the net assets acquired in a business combination to which AASB 3 *Business Combinations* applies. Hence, equity instruments issued in a business combination in exchange for control of the acquiree are not within the scope of this Standard. However, equity instruments granted to employees of the acquiree in their capacity as employees (e.g. in return for continued service) are within the scope of this Standard. Similarly, the cancellation, replacement or other modification of *share-based payment arrangements* because of a business combination or other equity restructuring shall be accounted for in accordance with this Standard.
- 6 This Standard does not apply to share-based payment transactions in which the entity receives or acquires goods or services under a contract within the scope of paragraphs 8-10 of AASB 132 *Financial Instruments: Presentation* or paragraphs 5-7 of AASB 139 *Financial Instruments: Recognition and Measurement*.

## Recognition

- 7 **An entity shall recognise the goods or services received or acquired in a share-based payment transaction when it obtains the goods or as the services are received. The entity shall recognise a corresponding increase in equity if the goods or services were received in an equity-settled share-based payment transaction, or a liability if the goods or services were acquired in a cash-settled share-based payment transaction.**
- 8 **When the goods or services received or acquired in a share-based payment transaction do not qualify for recognition as assets, they shall be recognised as expenses.**
- 9 Typically, an expense arises from the consumption of goods or services. For example, services are typically consumed immediately,

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

## Equity-settled Share-based Payment Transactions

### Overview

- 10 **For equity-settled share-based payment transactions, the entity shall measure the goods or services received, and the corresponding increase in equity, directly, at the fair value of the goods or services received, unless that fair value cannot be estimated reliably. If the entity cannot estimate reliably the fair value of the goods or services received, the entity shall measure their value, and the corresponding increase in equity, indirectly, by reference to<sup>1</sup> the fair value of the *equity instruments granted*.**
- 11 To apply the requirements of paragraph 10 to transactions with *employees and others providing similar services*<sup>2</sup>, the entity shall measure the fair value of the services received by reference to the fair value of the equity instruments granted, because typically it is not possible to estimate reliably the fair value of the services received, as explained in paragraph 12. The fair value of those equity instruments shall be measured at *grant date*.
- 12 Typically, shares, share options or other equity instruments are granted to employees as part of their remuneration package, in addition to a cash salary and other employment benefits. Usually, it is not possible to measure directly the services received for particular components of the employee's remuneration package. It might also not be possible to measure the fair value of the total remuneration package independently, without measuring directly the fair value of the equity instruments granted. Furthermore, shares or share options are

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1 This Standard uses the phrase 'by reference to' rather than 'at', because the transaction is ultimately measured by multiplying the fair value of the equity instruments granted, measured at the date specified in paragraph 11 or 13 (whichever is applicable), by the number of equity instruments that vest, as explained in paragraph 19.

2 In the remainder of this Standard, all references to employees also include others providing similar services.

sometimes granted as part of a bonus arrangement, rather than as a part of basic remuneration, for example, as an incentive to the employees to remain in the entity's employ or to reward them for their efforts in improving the entity's performance. By granting shares or share options, in addition to other remuneration, the entity is paying additional remuneration to obtain additional benefits. Estimating the fair value of those additional benefits is likely to be difficult. Because of the difficulty of measuring directly the fair value of the services received, the entity shall measure the fair value of the employee services received by reference to the fair value of the equity instruments granted.

- 13 To apply the requirements of paragraph 10 to transactions with parties other than employees, there shall be a rebuttable presumption that the fair value of the goods or services received can be estimated reliably. That fair value shall be measured at the date the entity obtains the goods or the counterparty renders service. In rare cases, if the entity rebuts this presumption because it cannot estimate reliably the fair value of the goods or services received, the entity shall measure the goods or services received, and the corresponding increase in equity, indirectly, by reference to the fair value of the equity instruments granted, measured at the date the entity obtains the goods or the counterparty renders service.

### **Transactions in which services are received**

- 14 If the equity instruments granted *vest* immediately, the counterparty is not required to complete a specified period of service before becoming unconditionally entitled to those equity instruments. In the absence of evidence to the contrary, the entity shall presume that services rendered by the counterparty as consideration for the equity instruments have been received. In this case, on grant date the entity shall recognise the services received in full, with a corresponding increase in equity.
- 15 If the equity instruments granted do not vest until the counterparty completes a specified period of service, the entity shall presume that the services to be rendered by the counterparty as consideration for those equity instruments will be received in the future, during the *vesting period*. The entity shall account for those services as they are rendered by the counterparty during the vesting period, with a corresponding increase in equity. For example:
- (a) if an employee is granted share options conditional upon completing three years' service, then the entity shall presume that the services to be rendered by the employee as consideration for the share options will be received in the future, over that three-year vesting period; or

- (b) if an employee is granted share options conditional upon the achievement of a performance condition and remaining in the entity's employ until that performance condition is satisfied, and the length of the vesting period varies depending on when that performance condition is satisfied, the entity shall presume that the services to be rendered by the employee as consideration for the share options will be received in the future, over the expected vesting period. The entity shall estimate the length of the expected vesting period at grant date, based on the most likely outcome of the performance condition. If the performance condition is a *market condition*, the estimate of the length of the expected vesting period shall be consistent with the assumptions used in estimating the fair value of the options granted, and shall not be subsequently revised. If the performance condition is not a market condition, the entity shall revise its estimate of the length of the vesting period, if necessary, if subsequent information indicates that the length of the vesting period differs from previous estimates.

## **Transactions measured by reference to the fair value of the equity instruments granted**

### **Determining the fair value of equity instruments granted**

- 16 For transactions measured by reference to the fair value of the equity instruments granted, an entity shall measure the fair value of equity instruments granted at the *measurement date*, based on market prices if available, taking into account the terms and conditions upon which those equity instruments were granted (subject to the requirements of paragraphs 19-22).
- 17 If market prices are not available, the entity shall estimate the fair value of the equity instruments granted using a valuation technique to estimate what the price of those equity instruments would have been on the measurement date in an arm's length transaction between knowledgeable, willing parties. The valuation technique shall be consistent with generally accepted valuation methodologies for pricing financial instruments, and shall incorporate all factors and assumptions that knowledgeable, willing market participants would consider in setting the price (subject to the requirements of paragraphs 19-22).
- 18 Appendix B contains further guidance on the measurement of the fair value of shares and share options, focusing on the specific terms and conditions that are common features of a grant of shares or share options to employees.

### **Treatment of vesting conditions**

- 19 A grant of equity instruments might be conditional upon satisfying specified *vesting conditions*. For example, a grant of shares or share options to an employee is typically conditional on the employee remaining in the entity's employ for a specified period of time. There might be performance conditions that must be satisfied, such as the entity achieving a specified growth in profit or a specified increase in the entity's share price. Vesting conditions, other than market conditions, shall not be taken into account when estimating the fair value of the shares or share options at the measurement date. Instead, vesting conditions shall be taken into account by adjusting the number of equity instruments included in the measurement of the transaction amount so that, ultimately, the amount recognised for goods or services received as consideration for the equity instruments granted shall be based on the number of equity instruments that eventually vest. Hence, on a cumulative basis, no amount is recognised for goods or services received if the equity instruments granted do not vest because of failure to satisfy a vesting condition, for example, the counterparty fails to complete a specified service period, or a performance condition is not satisfied, subject to the requirements of paragraph 21.
- 20 To apply the requirements of paragraph 19, the entity shall recognise an amount for the goods or services received during the vesting period based on the best available estimate of the number of equity instruments expected to vest and shall revise that estimate, if necessary, if subsequent information indicates that the number of equity instruments expected to vest differs from previous estimates. On vesting date, the entity shall revise the estimate to equal the number of equity instruments that ultimately vested, subject to the requirements of paragraph 21.
- 21 Market conditions, such as a target share price upon which vesting (or exercisability) is conditioned, shall be taken into account when estimating the fair value of the equity instruments granted. Therefore, for grants of equity instruments with market conditions, the entity shall recognise the goods or services received from a counterparty who satisfies all other vesting conditions (e.g. services received from an employee who remains in service for the specified period of service), irrespective of whether that market condition is satisfied.

### **Treatment of a reload feature**

- 22 For options with a *reload feature*, the reload feature shall not be taken into account when estimating the fair value of options granted at the measurement date. Instead, a *reload option* shall be accounted for as a new option grant, if and when a reload option is subsequently granted.

#### **After vesting date**

- 23 Having recognised the goods or services received in accordance with paragraphs 10-22, and a corresponding increase in equity, the entity shall make no subsequent adjustment to total equity after vesting date. For example, the entity shall not subsequently reverse the amount recognised for services received from an employee if the vested equity instruments are later forfeited or, in the case of share options, the options are not exercised. However, this requirement does not preclude the entity from recognising a transfer within equity, that is, a transfer from one component of equity to another.

#### **If the fair value of the equity instruments cannot be estimated reliably**

- 24 The requirements in paragraphs 16-23 apply when the entity is required to measure a share-based payment transaction by reference to the fair value of the equity instruments granted. In rare cases, the entity may be unable to estimate reliably the fair value of the equity instruments granted at the measurement date, in accordance with the requirements in paragraphs 16-22. In these rare cases only, the entity shall instead:
- (a) measure the equity instruments at their *intrinsic value*, initially at the date the entity obtains the goods or the counterparty renders service and subsequently at each reporting date and at the date of final settlement, with any change in intrinsic value recognised in profit or loss. For a grant of share options, the share-based payment arrangement is finally settled when the options are exercised, are forfeited (e.g. upon cessation of employment) or lapse (e.g. at the end of the option's life); and
  - (b) recognise the goods or services received based on the number of equity instruments that ultimately vest or (where applicable) are ultimately exercised. To apply this requirement to share options, for example, the entity shall recognise the goods or services received during the vesting period, if any, in accordance with paragraphs 14 and 15, except that the requirements in paragraph 15(b) concerning a market condition do not apply. The amount recognised for goods or services received during the vesting period shall be based on the number of share options expected to vest. The entity shall revise that estimate, if necessary, if subsequent information indicates that the number of share options expected to vest differs from previous estimates. On vesting date, the entity shall revise the estimate to equal the number of equity instruments that ultimately vested. After vesting date, the entity shall reverse the amount recognised for

goods or services received if the share options are later forfeited, or lapse at the end of the share option's life.

- 25 If an entity applies paragraph 24, it is not necessary to apply paragraphs 26-29, because any modifications to the terms and conditions on which the equity instruments were granted will be taken into account when applying the intrinsic value method set out in paragraph 24. However, if an entity settles a grant of equity instruments to which paragraph 24 has been applied:
- (a) if the settlement occurs during the vesting period, the entity shall account for the settlement as an acceleration of vesting, and shall therefore recognise immediately the amount that would otherwise have been recognised for services received over the remainder of the vesting period; and
  - (b) any payment made on settlement shall be accounted for as the repurchase of equity instruments, that is, as a deduction from equity, except to the extent that the payment exceeds the intrinsic value of the equity instruments, measured at the repurchase date. Any such excess shall be recognised as an expense.

### **Modifications to the terms and conditions on which equity instruments were granted, including cancellations and settlements**

- 26 An entity might modify the terms and conditions on which the equity instruments were granted. For example, it might reduce the exercise price of options granted to employees (i.e. reprice the options), which increases the fair value of those options. The requirements in paragraphs 27-29 to account for the effects of modifications are expressed in the context of share-based payment transactions with employees. However, the requirements shall also be applied to share-based payment transactions with parties other than employees that are measured by reference to the fair value of the equity instruments granted. In the latter case, any references in paragraphs 27-29 to grant date shall instead refer to the date the entity obtains the goods or the counterparty renders service.
- 27 The entity shall recognise, as a minimum, the services received measured at the grant date fair value of the equity instruments granted, unless those equity instruments do not vest because of failure to satisfy a vesting condition (other than a market condition) that was specified at grant date. This applies irrespective of any modifications to the terms and conditions on which the equity instruments were granted, or



a cancellation or settlement of that grant of equity instruments. In addition, the entity shall recognise the effects of modifications that increase the total fair value of the share-based payment arrangement or are otherwise beneficial to the employee. Guidance on applying this requirement is given in Appendix B.

- 28 If the entity cancels or settles a grant of equity instruments during the vesting period (other than a grant cancelled by forfeiture when the vesting conditions are not satisfied):
- (a) the entity shall account for the cancellation or settlement as an acceleration of vesting, and shall therefore recognise immediately the amount that otherwise would have been recognised for services received over the remainder of the vesting period;
  - (b) any payment made to the employee on the cancellation or settlement of the grant shall be accounted for as the repurchase of an equity interest, that is, as a deduction from equity, except to the extent that the payment exceeds the fair value of the equity instruments granted, measured at the repurchase date. Any such excess shall be recognised as an expense; and
  - (c) if new equity instruments are granted to the employee and, on the date when those new equity instruments are granted, the entity identifies the new equity instruments granted as replacement equity instruments for the cancelled equity instruments, the entity shall account for the granting of replacement equity instruments in the same way as a modification of the original grant of equity instruments, in accordance with paragraph 27 and the guidance in Appendix B. The incremental fair value granted is the difference between the fair value of the replacement equity instruments and the net fair value of the cancelled equity instruments, at the date the replacement equity instruments are granted. The net fair value of the cancelled equity instruments is their fair value, immediately before the cancellation, less the amount of any payment made to the employee on cancellation of the equity instruments that is accounted for as a deduction from equity in accordance with (b) above. If the entity does not identify new equity instruments granted as replacement equity instruments for the cancelled equity instruments, the entity shall account for those new equity instruments as a new grant of equity instruments.
- 29 If an entity repurchases vested equity instruments, the payment made to the employee shall be accounted for as a deduction from equity,

except to the extent that the payment exceeds the fair value of the equity instruments repurchased, measured at the repurchase date. Any such excess shall be recognised as an expense.

## **Cash-settled Share-based Payment Transactions**

- 30 For cash-settled share-based payment transactions, the entity shall measure the goods or services acquired and the liability incurred at the fair value of the liability. Until the liability is settled, the entity shall remeasure the fair value of the liability at each reporting date and at the date of settlement, with any changes in fair value recognised in profit or loss for the period.**
- 31 For example, an entity might grant share appreciation rights to employees as part of their remuneration package, whereby the employees will become entitled to a future cash payment (rather than an equity instrument), based on the increase in the entity's share price from a specified level over a specified period of time. Or an entity might grant to its employees a right to receive a future cash payment by granting to them a right to shares (including shares to be issued upon the exercise of share options) that are redeemable, either mandatorily (e.g. upon cessation of employment) or at the employee's option.
- 32 The entity shall recognise the services received, and a liability to pay for those services, as the employees render service. For example, some share appreciation rights vest immediately, and the employees are therefore not required to complete a specified period of service to become entitled to the cash payment. In the absence of evidence to the contrary, the entity shall presume that the services rendered by the employees in exchange for the share appreciation rights have been received. Thus, the entity shall recognise immediately the services received and a liability to pay for them. If the share appreciation rights do not vest until the employees have completed a specified period of service, the entity shall recognise the services received, and a liability to pay for them, as the employees render service during that period.
- 33 The liability shall be measured, initially and at each reporting date until settled, at the fair value of the share appreciation rights, by applying an option pricing model, taking into account the terms and conditions on which the share appreciation rights were granted, and the extent to which the employees have rendered service to date.

## **Share-based Payment Transactions with Cash Alternatives**

- 34 For share-based payment transactions in which the terms of the arrangement provide either the entity or the counterparty with the choice of whether the entity settles the transaction in cash (or other assets) or by issuing equity instruments, the entity shall account for that transaction, or the components of that transaction, as a cash-settled share-based payment transaction if, and to the extent that, the entity has incurred a liability to settle in cash or other assets, or as an equity-settled share-based payment transaction if, and to the extent that, no such liability has been incurred.

### **Share-based payment transactions in which the terms of the arrangement provide the counterparty with a choice of settlement**

- 35 If an entity has granted the counterparty the right to choose whether a share-based payment transaction is settled in cash<sup>3</sup> or by issuing equity instruments, the entity has granted a compound financial instrument, which includes a debt component (i.e. the counterparty's right to demand payment in cash) and an equity component (i.e. the counterparty's right to demand settlement in equity instruments rather than in cash). For transactions with parties other than employees, in which the fair value of the goods or services received is measured directly, the entity shall measure the equity component of the compound financial instrument as the difference between the fair value of the goods or services received and the fair value of the debt component, at the date when the goods or services are received.
- 36 For other transactions, including transactions with employees, the entity shall measure the fair value of the compound financial instrument at the measurement date, taking into account the terms and conditions on which the rights to cash or equity instruments were granted.
- 37 To apply paragraph 36, the entity shall first measure the fair value of the debt component, and then measure the fair value of the equity component – taking into account that the counterparty must forfeit the right to receive cash in order to receive the equity instrument. The fair value of the compound financial instrument is the sum of the fair values of the two components. However, share-based payment transactions in which the counterparty has the choice of settlement are often structured so that the fair value of one settlement alternative is

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3 In paragraphs 35 to 43, all references to cash also include other assets of the entity.

the same as the other. For example, the counterparty might have the choice of receiving share options or cash-settled share appreciation rights. In such cases, the fair value of the equity component is zero, and hence the fair value of the compound financial instrument is the same as the fair value of the debt component. Conversely, if the fair values of the settlement alternatives differ, the fair value of the equity component usually will be greater than zero, in which case the fair value of the compound financial instrument will be greater than the fair value of the debt component.

- 38 The entity shall account separately for the goods or services received or acquired in respect of each component of the compound financial instrument. For the debt component, the entity shall recognise the goods or services acquired, and a liability to pay for those goods or services, as the counterparty supplies goods or renders service, in accordance with the requirements applying to cash-settled share-based payment transactions (paragraphs 30-33). For the equity component (if any), the entity shall recognise the goods or services received, and an increase in equity, as the counterparty supplies goods or renders service, in accordance with the requirements applying to equity-settled share-based payment transactions (paragraphs 10-29).
- 39 At the date of settlement, the entity shall remeasure the liability to its fair value. If the entity issues equity instruments on settlement rather than paying cash, the liability shall be transferred direct to equity, as the consideration for the equity instruments issued.
- 40 If the entity pays in cash on settlement rather than issuing equity instruments, that payment shall be applied to settle the liability in full. Any equity component previously recognised shall remain within equity. By electing to receive cash on settlement, the counterparty forfeited the right to receive equity instruments. However, this requirement does not preclude the entity from recognising a transfer within equity, that is, a transfer from one component of equity to another.

### **Share-based payment transactions in which the terms of the arrangement provide the entity with a choice of settlement**

- 41 For a share-based payment transaction in which the terms of the arrangement provide an entity with the choice of whether to settle in cash or by issuing equity instruments, the entity shall determine whether it has a present obligation to settle in cash and account for the share-based payment transaction accordingly. The entity has a present obligation to settle in cash if the choice of settlement in equity instruments has no commercial substance (e.g. because the entity is

legally prohibited from issuing shares), or the entity has a past practice or a stated policy of settling in cash, or generally settles in cash whenever the counterparty asks for cash settlement.

- 42 If the entity has a present obligation to settle in cash, it shall account for the transaction in accordance with the requirements applying to cash-settled share-based payment transactions, in paragraphs 30-33.
- 43 If no such obligation exists, the entity shall account for the transaction in accordance with the requirements applying to equity-settled share-based payment transactions, in paragraphs 10-29. Upon settlement:
- (a) if the entity elects to settle in cash, the cash payment shall be accounted for as the repurchase of an equity interest, that is, as a deduction from equity, except as noted in (c) below;
  - (b) if the entity elects to settle by issuing equity instruments, no further accounting is required (other than a transfer from one component of equity to another, if necessary), except as noted in (c) below; and
  - (c) if the entity elects the settlement alternative with the higher fair value, as at the date of settlement, the entity shall recognise an additional expense for the excess value given, that is, the difference between the cash paid and the fair value of the equity instruments that would otherwise have been issued, or the difference between the fair value of the equity instruments issued and the amount of cash that would otherwise have been paid, whichever is applicable.

## Disclosures

- 44 **An entity shall disclose information that enables users of the financial report to understand the nature and extent of share-based payment arrangements that existed during the period.**
- 45 To give effect to the principle in paragraph 44, the entity shall disclose at least the following:
- (a) a description of each type of share-based payment arrangement that existed at any time during the period, including the general terms and conditions of each arrangement, such as vesting requirements, the maximum term of options granted, and the method of settlement (e.g. whether in cash or equity). An entity with substantially similar types of share-based payment arrangements may aggregate this information, unless separate

disclosure of each arrangement is necessary to satisfy the principle in paragraph 44;

- (b) the number and weighted average exercise prices of share options for each of the following groups of options:
  - (i) outstanding at the beginning of the period;
  - (ii) granted during the period;
  - (iii) forfeited during the period;
  - (iv) exercised during the period;
  - (v) expired during the period;
  - (vi) outstanding at the end of the period; and
  - (vii) exercisable at the end of the period;
- (c) for share options exercised during the period, the weighted average share price at the date of exercise. If options were exercised on a regular basis throughout the period, the entity may instead disclose the weighted average share price during the period; and
- (d) for share options outstanding at the end of the period, the range of exercise prices and weighted average remaining contractual life. If the range of exercise prices is wide, the outstanding options shall be divided into ranges that are meaningful for assessing the number and timing of additional shares that may be issued and the cash that may be received upon exercise of those options.

**46 An entity shall disclose information that enables users of the financial report 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.**

- 47 If the entity has measured the fair value of goods or services received as consideration for equity instruments of the entity indirectly, by reference to the fair value of the equity instruments granted, to give effect to the principle in paragraph 46, the entity shall disclose at least the following:

- (a) for share options granted during the period, the weighted average fair value of those options at the measurement date and information on how that fair value was measured, including:
  - (i) the option pricing model used and the inputs to that model, including the weighted average share price, exercise price, expected volatility, option life, expected dividends, the risk-free interest rate and any other inputs to the model, including the method used and the assumptions made to incorporate the effects of expected early exercise;
  - (ii) how expected volatility was determined, including an explanation of the extent to which expected volatility was based on historical volatility; and
  - (iii) whether and how any other features of the option grant were incorporated into the measurement of fair value, such as a market condition;
- (b) for other equity instruments granted during the period (i.e. other than share options), the number and weighted average fair value of those equity instruments at the measurement date, and information on how that fair value was measured, including:
  - (i) if fair value was not measured on the basis of an observable market price, how it was determined;
  - (ii) whether and how expected dividends were incorporated into the measurement of fair value; and
  - (iii) whether and how any other features of the equity instruments granted were incorporated into the measurement of fair value; and
- (c) for share-based payment arrangements that were modified during the period:
  - (i) an explanation of those modifications;
  - (ii) the incremental fair value granted (as a result of those modifications); and
  - (iii) information on how the incremental fair value granted was measured, consistently with the requirements set out in (a) and (b) above, where applicable.

- 48 If the entity has measured directly the fair value of goods or services received during the period, the entity shall disclose how that fair value was determined, for example, whether fair value was measured at a market price for those goods or services.
- 49 If the entity has rebutted the presumption in paragraph 13, it shall disclose that fact, and give an explanation of why the presumption was rebutted.
- 50 An entity shall disclose information that enables users of the financial report to understand the effect of share-based payment transactions on the entity's profit or loss for the period and on its financial position.**
- 51 To give effect to the principle in paragraph 50, the entity shall disclose at least the following:
- (a) the total expense recognised for the period arising from share-based payment transactions in which the goods or services received did not qualify for recognition as assets and hence were recognised immediately as an expense, including separate disclosure of that portion of the total expense that arises from transactions accounted for as equity-settled share-based payment transactions; and
  - (b) for liabilities arising from share-based payment transactions:
    - (i) the total carrying amount at the end of the period; and
    - (ii) the total intrinsic value at the end of the period of liabilities for which the counterparty's right to cash or other assets had vested by the end of the period (e.g. vested share appreciation rights).
- 52 If the information required to be disclosed by this Standard does not satisfy the principles in paragraphs 44, 46 and 50, the entity shall disclose such additional information as is necessary to satisfy them.

## **Transitional Provisions**

- Aus52.1 The following transitional paragraphs shall not be applied by entities that have previously applied this Standard, unless required to do so by another Australian equivalent to IFRSs.
- 53 For equity-settled share-based payment transactions, the entity shall apply this Standard to grants of shares, share options or other equity



instruments that were granted after 7 November 2002 and had not yet vested at the application date of this Standard.

- 54 The entity is encouraged, but not required, to apply this Standard to other grants of equity instruments if the entity has disclosed publicly the fair value of those equity instruments, determined at the measurement date.
- 55 For all grants of equity instruments to which this Standard is applied, the entity shall restate comparative information and, where applicable, adjust the opening balance of retained earnings for the earliest period presented.
- 56 For all grants of equity instruments to which this Standard has not been applied (e.g. equity instruments granted on or before 7 November 2002), the entity shall nevertheless disclose the information required by paragraphs 44 and 45.
- 57 If, after the Standard becomes applicable, an entity modifies the terms or conditions of a grant of equity instruments to which this Standard has not been applied, the entity shall nevertheless apply paragraphs 26-29 to account for any such modifications.
- 58 For liabilities arising from share-based payment transactions existing at the application date of this Standard, the entity shall apply the Standard retrospectively. For these liabilities, the entity shall restate comparative information, including adjusting the opening balance of retained earnings in the earliest period presented for which comparative information has been restated, except that the entity is not required to restate comparative information to the extent that the information relates to a period or date that is earlier than 7 November 2002.
- 59 The entity is encouraged, but not required, to apply retrospectively the Standard to other liabilities arising from share-based payment transactions, for example, to liabilities that were settled during a period for which comparative information is presented.

## **Effective Date of IFRS 2**

- 60 [Deleted by the AASB]

## APPENDIX A

### DEFINED TERMS

*This appendix is an integral part of AASB 2.*

<b>cash-settled share-based payment transaction</b>	A <b>share-based payment transaction</b> in which the entity acquires goods or services by incurring a liability to transfer cash or other assets to the supplier of those goods or services for amounts that are based on the price (or value) of the entity's shares or other <b>equity instruments</b> of the entity.
<b>employees and others providing similar services</b>	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. For example, the term encompasses all management personnel, that is, those persons having authority and responsibility for planning, directing and controlling the activities of the entity, including non-executive directors.
<b>equity instrument</b>	A contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities <sup>1</sup> .
<b>equity instrument granted</b>	The right (conditional or unconditional) to an <b>equity instrument</b> of the entity conferred by the entity on another party, under a <b>share-based payment arrangement</b> .
<b>equity-settled share-based payment transaction</b>	A <b>share-based payment transaction</b> in which the entity receives goods or services as consideration for <b>equity instruments</b> of the entity (including shares or <b>share options</b> ).

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<sup>1</sup> The *Framework for the Preparation and Presentation of Financial Statements* defines a liability as a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits (i.e. an outflow of cash or other assets of the entity).

<b>fair value</b>	The amount for which an asset could be exchanged, a liability settled, or an <b>equity instrument granted</b> could be exchanged, between knowledgeable, willing parties in an arm's length transaction.
<b>grant date</b>	The date at which the entity and another party (including an employee) agree to a <b>share-based payment arrangement</b> , 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 <b>equity instruments</b> of the entity, provided the specified <b>vesting conditions</b> , 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.
<b>intrinsic value</b>	The difference between the <b>fair value</b> of the shares to which the counterparty has the (conditional or unconditional) right to subscribe or which it has the right to receive, and the price (if any) the counterparty is (or will be) required to pay for those shares. For example, a <b>share option</b> with an exercise price of CU15 <sup>2</sup> , on a share with a <b>fair value</b> of CU20, has an intrinsic value of CU5.
<b>market condition</b>	A condition upon which the exercise price, vesting or exercisability of an <b>equity instrument</b> depends that is related to the market price of the entity's <b>equity instruments</b> , such as attaining a specified share price or a specified amount of <b>intrinsic value</b> of a <b>share option</b> , or achieving a specified target that is based on the market price of the entity's <b>equity instruments</b> relative to an index of market prices of <b>equity instruments</b> of other entities.
<b>measurement date</b>	The date at which the <b>fair value</b> of the <b>equity instruments granted</b> is measured for the purposes of this Standard. For transactions with <b>employees and others providing similar services</b> , the measurement date is <b>grant date</b> . For transactions with parties other than employees (and those providing similar services), the measurement date is the date the entity obtains the goods or the counterparty renders service.

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2 In this appendix, monetary amounts are denominated in 'currency units' (CU).

<b>reload feature</b>	A feature that provides for an automatic grant of additional <b>share options</b> whenever the option holder exercises previously granted options using the entity's shares, rather than cash, to satisfy the exercise price.
<b>reload option</b>	A new <b>share option</b> granted when a share is used to satisfy the exercise price of a previous <b>share option</b> .
<b>share-based payment arrangement</b>	An agreement between the entity and another party (including an employee) to enter into a <b>share-based payment transaction</b> , which thereby entitles the other party to receive cash or other assets of the entity for amounts that are based on the price of the entity's shares or other <b>equity instruments</b> of the entity, or to receive <b>equity instruments</b> of the entity, provided the specified <b>vesting conditions</b> , if any, are met.
<b>share-based payment transaction</b>	A transaction in which the entity receives goods or services as consideration for <b>equity instruments</b> of the entity (including shares or <b>share options</b> ), or acquires goods or services by incurring liabilities to the supplier of those goods or services for amounts that are based on the price of the entity's shares or other <b>equity instruments</b> of the entity.
<b>share option</b>	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.
<b>vest</b>	To become an entitlement. Under a <b>share-based payment arrangement</b> , a counterparty's right to receive cash, other assets, or <b>equity instruments</b> of the entity vests upon satisfaction of any specified <b>vesting conditions</b> .
<b>vesting conditions</b>	The conditions that must be satisfied for the counterparty to become entitled to receive cash, other assets or <b>equity instruments</b> of the entity, under a <b>share-based payment arrangement</b> . 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.

## **APPENDIX B**

### **APPLICATION GUIDANCE**

*This appendix is an integral part of AASB 2.*

#### **Estimating the fair value of equity instruments granted**

- B1 Paragraphs B2-B41 of this appendix discuss measurement of the fair value of shares and share options granted, focusing on the specific terms and conditions that are common features of a grant of shares or share options to employees. Therefore, it is not exhaustive. Furthermore, because the valuation issues discussed below focus on shares and share options granted to employees, it is assumed that the fair value of the shares or share options is measured at grant date. However, many of the valuation issues discussed below (e.g. determining expected volatility) also apply in the context of estimating the fair value of shares or share options granted to parties other than employees at the date the entity obtains the goods or the counterparty renders service.

#### **Shares**

- B2 For shares granted to employees, the fair value of the shares shall be measured at the market price of the entity's shares (or an estimated market price, if the entity's shares are not publicly traded), adjusted to take into account the terms and conditions upon which the shares were granted (except for vesting conditions that are excluded from the measurement of fair value in accordance with paragraphs 19-21).
- B3 For example, if the employee is not entitled to receive dividends during the vesting period, this factor shall be taken into account when estimating the fair value of the shares granted. Similarly, if the shares are subject to restrictions on transfer after vesting date, that factor shall be taken into account, but only to the extent that the post-vesting restrictions affect the price that a knowledgeable, willing market participant would pay for that share. For example, if the shares are actively traded in a deep and liquid market, post-vesting transfer restrictions may have little, if any, effect on the price that a knowledgeable, willing market participant would pay for those shares. Restrictions on transfer or other restrictions that exist during the vesting period shall not be taken into account when estimating the grant date fair value of the shares granted, because those restrictions

stem from the existence of vesting conditions, which are accounted for in accordance with paragraphs 19-21.

## **Share options**

- B4 For share options granted to employees, in many cases market prices are not available, because the options granted are subject to terms and conditions that do not apply to traded options. If traded options with similar terms and conditions do not exist, the fair value of the options granted shall be estimated by applying an option pricing model.
- B5 The entity shall consider factors that knowledgeable, willing market participants would consider in selecting the option pricing model to apply. For example, many employee options have long lives, are usually exercisable during the period between vesting date and the end of the options' life, and are often exercised early. These factors should be considered when estimating the grant date fair value of the options. For many entities, this might preclude the use of the Black-Scholes-Merton formula, which does not allow for the possibility of exercise before the end of the option's life and may not adequately reflect the effects of expected early exercise. It also does not allow for the possibility that expected volatility and other model inputs might vary over the option's life. However, for share options with relatively short contractual lives, or that must be exercised within a short period of time after vesting date, the factors identified above may not apply. In these instances, the Black-Scholes-Merton formula may produce a value that is substantially the same as a more flexible option pricing model.
- B6 All option pricing models take into account, as a minimum, the following factors:
- (a) the exercise price of the option;
  - (b) the life of the option;
  - (c) the current price of the underlying shares;
  - (d) the expected volatility of the share price;
  - (e) the dividends expected on the shares (if appropriate); and
  - (f) the risk-free interest rate for the life of the option.
- B7 Other factors that knowledgeable, willing market participants would consider in setting the price shall also be taken into account (except for

vesting conditions and reload features that are excluded from the measurement of fair value in accordance with paragraphs 19-22).

- B8 For example, a share option granted to an employee typically cannot be exercised during specified periods (e.g. during the vesting period or during periods specified by securities regulators). This factor shall be taken into account if the option pricing model applied would otherwise assume that the option could be exercised at any time during its life. However, if an entity uses an option pricing model that values options that can be exercised only at the end of the options' life, no adjustment is required for the inability to exercise them during the vesting period (or other periods during the options' life), because the model assumes that the options cannot be exercised during those periods.
- B9 Similarly, another factor common to employee share options is the possibility of early exercise of the option, for example, because the option is not freely transferable, or because the employee must exercise all vested options upon cessation of employment. The effects of expected early exercise shall be taken into account, as discussed in paragraphs B16-B21.
- B10 Factors that a knowledgeable, willing market participant would not consider in setting the price of a share option (or other equity instrument) shall not be taken into account when estimating the fair value of share options (or other equity instruments) granted. For example, for share options granted to employees, factors that affect the value of the option from the individual employee's perspective only are not relevant to estimating the price that would be set by a knowledgeable, willing market participant.

#### **Inputs to option pricing models**

- B11 In estimating the expected volatility of and dividends on the underlying shares, the objective is to approximate the expectations that would be reflected in a current market or negotiated exchange price for the option. Similarly, when estimating the effects of early exercise of employee share options, the objective is to approximate the expectations that an outside party with access to detailed information about employees' exercise behaviour would develop based on information available at the grant date.
- B12 Often, there is likely to be a range of reasonable expectations about future volatility, dividends and exercise behaviour. If so, an expected value should be calculated, by weighting each amount within the range by its associated probability of occurrence.



- B13 Expectations about the future are generally based on experience, modified if the future is reasonably expected to differ from the past. In some circumstances, identifiable factors may indicate that unadjusted historical experience is a relatively poor predictor of future experience. For example, if an entity with two distinctly different lines of business disposes of the one that was significantly less risky than the other, historical volatility may not be the best information on which to base reasonable expectations for the future.
- B14 In other circumstances, historical information may not be available. For example, a newly listed entity will have little, if any, historical data on the volatility of its share price. Unlisted and newly listed entities are discussed further below.
- B15 In summary, an entity should not simply base estimates of volatility, exercise behaviour and dividends on historical information without considering the extent to which the past experience is expected to be reasonably predictive of future experience.

***Expected early exercise***

- B16 Employees often exercise share options early, for a variety of reasons. For example, employee share options are typically non-transferable. This often causes employees to exercise their share options early, because that is the only way for the employees to liquidate their position. Also, employees who cease employment are usually required to exercise any vested options within a short period of time, otherwise the share options are forfeited. This factor also causes the early exercise of employee share options. Other factors causing early exercise are risk aversion and lack of wealth diversification.
- B17 The means by which the effects of expected early exercise are taken into account depends upon the type of option pricing model applied. For example, expected early exercise could be taken into account by using an estimate of the option's expected life (which, for an employee share option, is the period of time from grant date to the date on which the option is expected to be exercised) as an input into an option pricing model (e.g. the Black-Scholes-Merton formula). Alternatively, expected early exercise could be modelled in a binomial or similar option pricing model that uses contractual life as an input.
- B18 Factors to consider in estimating early exercise include:
- (a) the length of the vesting period, because the share option typically cannot be exercised until the end of the vesting period. Hence, determining the valuation implications of expected early exercise is based on the assumption that the options will vest.

The implications of vesting conditions are discussed in paragraphs 19-21;

- (b) the average length of time similar options have remained outstanding in the past;
- (c) the price of the underlying shares. Experience may indicate that the employees tend to exercise options when the share price reaches a specified level above the exercise price;
- (d) the employee's level within the organisation. For example, experience might indicate that higher-level employees tend to exercise options later than lower-level employees (discussed further in paragraph B21); and
- (e) expected volatility of the underlying shares. On average, employees might tend to exercise options on highly volatile shares earlier than on shares with low volatility.

B19 As noted in paragraph B17, the effects of early exercise could be taken into account by using an estimate of the option's expected life as an input into an option pricing model. When estimating the expected life of share options granted to a group of employees, the entity could base that estimate on an appropriately weighted average expected life for the entire employee group or on appropriately weighted average lives for subgroups of employees within the group, based on more detailed data about employees' exercise behaviour (discussed further below).

B20 Separating an option grant into groups for employees with relatively homogeneous exercise behaviour is likely to be important. Option value is not a linear function of option term; value increases at a decreasing rate as the term lengthens. For example, if all other assumptions are equal, although a two-year option is worth more than a one-year option, it is not worth twice as much. That means that calculating estimated option value on the basis of a single weighted average life that includes widely differing individual lives would overstate the total fair value of the share options granted. Separating options granted into several groups, each of which has a relatively narrow range of lives included in its weighted average life, reduces that overstatement.

B21 Similar considerations apply when using a binomial or similar model. For example, the experience of an entity that grants options broadly to all levels of employees might indicate that top-level executives tend to hold their options longer than middle-management employees hold theirs and that lower-level employees tend to exercise their options earlier than any other group. In addition, employees who are

encouraged or required to hold a minimum amount of their employer's equity instruments, including options, might on average exercise options later than employees not subject to that provision. In those situations, separating options by groups of recipients with relatively homogeneous exercise behaviour will result in a more accurate estimate of the total fair value of the share options granted.

### ***Expected volatility***

- B22 Expected volatility is a measure of the amount by which a price is expected to fluctuate during a period. The measure of volatility used in option pricing models is the annualised standard deviation of the continuously compounded rates of return on the share over a period of time. Volatility is typically expressed in annualised terms that are comparable regardless of the time period used in the calculation, for example, daily, weekly or monthly price observations.
- B23 The rate of return (which may be positive or negative) on a share for a period measures how much a shareholder has benefited from dividends and appreciation (or depreciation) of the share price.
- B24 The expected annualised volatility of a share is the range within which the continuously-compounded annual rate of return is expected to fall approximately two-thirds of the time. For example, to say that a share with an expected continuously-compounded rate of return of 12 per cent has a volatility of 30 per cent means that the probability that the rate of return on the share for one year will be between –18 per cent (12% – 30%) and 42 per cent (12% + 30%) is approximately two-thirds. If the share price is CU100 at the beginning of the year and no dividends are paid, the year-end share price would be expected to be between CU83.53 ( $CU100 \times e^{-0.18}$ ) and CU152.20 ( $CU100 \times e^{0.42}$ ) approximately two-thirds of the time.
- B25 Factors to consider in estimating expected volatility include:
- (a) implied volatility from traded share options on the entity's shares, or other traded instruments of the entity that include option features (such as convertible debt), if any;
  - (b) the historical volatility of the share price over the most recent period that is generally commensurate with the expected term of the option (taking into account the remaining contractual life of the option and the effects of expected early exercise);
  - (c) the length of time an entity's shares have been publicly traded. A newly listed entity might have a high historical volatility,

compared with similar entities that have been listed longer. Further guidance for newly listed entities is given below;

- (d) the tendency of volatility to revert to its mean, that is, its long-term average level, and other factors indicating that expected future volatility might differ from past volatility. For example, if an entity's share price was extraordinarily volatile for some identifiable period of time because of a failed takeover bid or a major restructuring, that period could be disregarded in computing historical average annual volatility; and
- (e) appropriate and regular intervals for price observations. The price observations should be consistent from period to period. For example, an entity might use the closing price for each week or the highest price for the week, but it should not use the closing price for some weeks and the highest price for other weeks. Also, the price observations should be expressed in the same currency as the exercise price.

#### **Newly listed entities**

- B26 As noted in paragraph B25, an entity should consider historical volatility of the share price over the most recent period that is generally commensurate with the expected option term. If a newly listed entity does not have sufficient information on historical volatility, it should nevertheless compute historical volatility for the longest period for which trading activity is available. It could also consider the historical volatility of similar entities following a comparable period in their lives. For example, an entity that has been listed for only one year and grants options with an average expected life of five years might consider the pattern and level of historical volatility of entities in the same industry for the first six years in which the shares of those entities were publicly traded.

#### **Unlisted entities**

- B27 An unlisted entity will not have historical information to consider when estimating expected volatility. Some factors to consider instead are set out below.
- B28 In some cases, an unlisted entity that regularly issues options or shares to employees (or other parties) might have set up an internal market for its shares. The volatility of those share prices could be considered when estimating expected volatility.
- B29 Alternatively, the entity could consider the historical or implied volatility of similar listed entities, for which share price or option price

information is available, to use when estimating expected volatility. This would be appropriate if the entity has based the value of its shares on the share prices of similar listed entities.

- B30 If the entity has not based its estimate of the value of its shares on the share prices of similar listed entities, and has instead used another valuation methodology to value its shares, the entity could derive an estimate of expected volatility consistent with that valuation methodology. For example, the entity might value its shares on a net asset or earnings basis. It could consider the expected volatility of those net asset values or earnings.

### ***Expected dividends***

- B31 Whether expected dividends should be taken into account when measuring the fair value of shares or options granted depends on whether the counterparty is entitled to dividends or dividend equivalents.
- B32 For example, if employees were granted options and are entitled to dividends on the underlying shares or dividend equivalents (which might be paid in cash or applied to reduce the exercise price) between grant date and exercise date, the options granted should be valued as if no dividends will be paid on the underlying shares, that is, the input for expected dividends should be zero.
- B33 Similarly, when the grant date fair value of shares granted to employees is estimated, no adjustment is required for expected dividends if the employee is entitled to receive dividends paid during the vesting period.
- B34 Conversely, if the employees are not entitled to dividends or dividend equivalents during the vesting period (or before exercise, in the case of an option), the grant date valuation of the rights to shares or options should take expected dividends into account. That is to say, when the fair value of an option grant is estimated, expected dividends should be included in the application of an option pricing model. When the fair value of a share grant is estimated, that valuation should be reduced by the present value of dividends expected to be paid during the vesting period.
- B35 Option pricing models generally call for expected dividend yield. However, the models may be modified to use an expected dividend amount rather than a yield. An entity may use either its expected yield or its expected payments. If the entity uses the latter, it should consider its historical pattern of increases in dividends. For example, if an entity's policy has generally been to increase dividends by

approximately 3 per cent per year, its estimated option value should not assume a fixed dividend amount throughout the option's life unless there is evidence that supports that assumption.

- B36 Generally, the assumption about expected dividends should be based on publicly available information. An entity that does not pay dividends and has no plans to do so should assume an expected dividend yield of zero. However, an emerging entity with no history of paying dividends might expect to begin paying dividends during the expected lives of its employee share options. Those entities could use an average of their past dividend yield (zero) and the mean dividend yield of an appropriately comparable peer group.

***Risk-free interest rate***

- B37 Typically, the risk-free interest rate is the implied yield currently available on zero-coupon government issues of the country in whose currency the exercise price is expressed, with a remaining term equal to the expected term of the option being valued (based on the option's remaining contractual life and taking into account the effects of expected early exercise). It may be necessary to use an appropriate substitute, if no such government issues exist or circumstances indicate that the implied yield on zero-coupon government issues is not representative of the risk-free interest rate (for example, in high inflation economies). Also, an appropriate substitute should be used if market participants would typically determine the risk-free interest rate by using that substitute, rather than the implied yield of zero-coupon government issues, when estimating the fair value of an option with a life equal to the expected term of the option being valued.

***Capital structure effects***

- B38 Typically, third parties, not the entity, write traded share options. When these share options are exercised, the writer delivers shares to the option holder. Those shares are acquired from existing shareholders. Hence the exercise of traded share options has no dilutive effect.
- B39 In contrast, if share options are written by the entity, new shares are issued when those share options are exercised (either actually issued or issued in substance, if shares previously repurchased and held in treasury are used). Given that the shares will be issued at the exercise price rather than the current market price at the date of exercise, this actual or potential dilution might reduce the share price, so that the option holder does not make as large a gain on exercise as on exercising an otherwise similar traded option that does not dilute the share price.

- B40 Whether this has a significant effect on the value of the share options granted depends on various factors, such as the number of new shares that will be issued on exercise of the options compared with the number of shares already issued. Also, if the market already expects that the option grant will take place, the market may have already factored the potential dilution into the share price at the date of grant.
- B41 However, the entity should consider whether the possible dilutive effect of the future exercise of the share options granted might have an impact on their estimated fair value at grant date. Option pricing models can be adapted to take into account this potential dilutive effect.

## **Modifications to equity-settled share-based payment arrangements**

- B42 Paragraph 27 requires that, irrespective of any modifications to the terms and conditions on which the equity instruments were granted, or a cancellation or settlement of that grant of equity instruments, the entity should recognise, as a minimum, the services received measured at the grant date fair value of the equity instruments granted, unless those equity instruments do not vest because of failure to satisfy a vesting condition (other than a market condition) that was specified at grant date. In addition, the entity should recognise the effects of modifications that increase the total fair value of the share-based payment arrangement or are otherwise beneficial to the employee.
- B43 To apply the requirements of paragraph 27:
- (a) if the modification increases the fair value of the equity instruments granted (e.g. by reducing the exercise price), measured immediately before and after the modification, the entity shall include the incremental fair value granted in the measurement of the amount recognised for services received as consideration for the equity instruments granted. The incremental fair value granted is the difference between the fair value of the modified equity instrument and that of the original equity instrument, both estimated as at the date of the modification. If the modification occurs during the vesting period, the incremental fair value granted is included in the measurement of the amount recognised for services received over the period from the modification date until the date when the modified equity instruments vest, in addition to the amount based on the grant date fair value of the original equity instruments, which is recognised over the remainder of the original vesting period. If the modification occurs after vesting

date, the incremental fair value granted is recognised immediately, or over the vesting period if the employee is required to complete an additional period of service before becoming unconditionally entitled to those modified equity instruments;

- (b) similarly, if the modification increases the number of equity instruments granted, the entity shall include the fair value of the additional equity instruments granted, measured at the date of the modification, in the measurement of the amount recognised for services received as consideration for the equity instruments granted, consistently with the requirements in (a) above. For example, if the modification occurs during the vesting period, the fair value of the additional equity instruments granted is included in the measurement of the amount recognised for services received over the period from the modification date until the date when the additional equity instruments vest, in addition to the amount based on the grant date fair value of the equity instruments originally granted, which is recognised over the remainder of the original vesting period; and
- (c) if the entity modifies the vesting conditions in a manner that is beneficial to the employee, for example, by reducing the vesting period or by modifying or eliminating a performance condition (other than a market condition, changes to which are accounted for in accordance with (a) above), the entity shall take the modified vesting conditions into account when applying the requirements of paragraphs 19-21.

B44 Furthermore, if the entity modifies the terms or conditions of the equity instruments granted in a manner that reduces the total fair value of the share-based payment arrangement, or is not otherwise beneficial to the employee, the entity shall nevertheless continue to account for the services received as consideration for the equity instruments granted as if that modification had not occurred (other than a cancellation of some or all the equity instruments granted, which shall be accounted for in accordance with paragraph 28). For example:

- (a) if the modification reduces the fair value of the equity instruments granted, measured immediately before and after the modification, the entity shall not take into account that decrease in fair value and shall continue to measure the amount recognised for services received as consideration for the equity instruments based on the grant date fair value of the equity instruments granted;



- (b) if the modification reduces the number of equity instruments granted to an employee, that reduction shall be accounted for as a cancellation of that portion of the grant, in accordance with the requirements of paragraph 28; and
- (c) if the entity modifies the vesting conditions in a manner that is not beneficial to the employee, for example, by increasing the vesting period or by modifying or adding a performance condition (other than a market condition, changes to which are accounted for in accordance with (a) above), the entity shall not take the modified vesting conditions into account when applying the requirements of paragraphs 19-21.

## IMPLEMENTATION GUIDANCE

### *AASB 2 Share-based Payment*

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## IMPLEMENTATION GUIDANCE

### ***AASB 2 Share-based Payment***

*This guidance accompanies, but is not part of, AASB 2.*

#### **Definition of grant date**

- IG1 AASB 2 defines grant date as the date at which the entity and the employee (or other party providing similar services) agree to a share-based payment arrangement, being when the entity and the counterparty have a shared understanding of the terms and conditions of the arrangement. At grant date the entity confers on the counterparty the right to cash, other assets, or equity instruments of the entity, provided the specified vesting conditions, if any, are met. If that agreement is subject to an approval process (for example, by shareholders), grant date is the date when that approval is obtained.
- IG2 As noted above, grant date is when both parties agree to a share-based payment arrangement. The word ‘agree’ is used in its usual sense, which means that there must be both an offer and acceptance of that offer. Hence, the date at which one party makes an offer to another party is not grant date. The date of grant is when that other party accepts the offer. In some instances, the counterparty explicitly agrees to the arrangement, for example, by signing a contract. In other instances, agreement might be implicit, for example, for many share-based payment arrangements with employees, the employees’ agreement is evidenced by their commencing to render services.
- IG3 Furthermore, for both parties to have agreed to the share-based payment arrangement, both parties must have a shared understanding of the terms and conditions of the arrangement. Therefore, if some of the terms and conditions of the arrangement are agreed on one date, with the remainder of the terms and conditions agreed on a later date, then grant date is on that later date, when all of the terms and conditions have been agreed. For example, if an entity agrees to issue share options to an employee, but the exercise price of the options will be set by a compensation committee that meets in three months’ time, grant date is when the exercise price is set by the compensation committee.
- IG4 In some cases, grant date might occur after the employees to whom the equity instruments were granted have begun rendering services. For example, if a grant of equity instruments is subject to shareholder approval, grant date might occur some months after the employees have begun rendering services in respect of that grant. The Standard

requires the entity to recognise the services when received. In this situation, the entity should estimate the grant date fair value of the equity instruments (e.g. by estimating the fair value of the equity instruments at the end of the reporting period), for the purposes of recognising the services received during the period between service commencement date and grant date. Once the date of grant has been established, the entity should revise the earlier estimate so that the amounts recognised for services received in respect of the grant are ultimately based on the grant date fair value of the equity instruments.

## **Measurement date for transactions with parties other than employees**

- IG5 For transactions with parties other than employees (and others providing similar services) that are measured by reference to the fair value of the equity instruments granted, paragraph 13 of AASB 2 requires the entity to measure that fair value at the date the entity obtains the goods or the counterparty renders service.
- IG6 If the goods or services are received on more than one date, the entity should measure the fair value of the equity instruments granted on each date when goods or services are received. The entity should apply that fair value when measuring the goods or services received on that date.
- IG7 However, an approximation could be used in some cases. For example, if an entity received services continuously during a three-month period, and its share price did not change significantly during that period, the entity could use the average share price during the three-month period when estimating the fair value of the equity instruments granted.

## **Transitional arrangements**

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

## Illustrative examples

### Equity-settled share-based payment transactions

IG9 For equity-settled transactions measured by reference to the fair value of the equity instruments granted, paragraph 19 of AASB 2 states that vesting conditions, other than market conditions<sup>1</sup>, are not taken into account when estimating the fair value of the shares or share options at the measurement date (i.e. grant date, for transactions with employees and others providing similar services). Instead, vesting conditions are taken into account by adjusting the number of equity instruments included in the measurement of the transaction amount so that, ultimately, the amount recognised for goods or services received as consideration for the equity instruments granted is based on the number of equity instruments that eventually vest. Hence, on a cumulative basis, no amount is recognised for goods or services received if the equity instruments granted do not vest because of failure to satisfy a vesting condition, for example, the counterparty fails to complete a specified service period, or a performance condition is not satisfied. This accounting method is known as the modified grant date method, because the number of equity instruments included in the determination of the transaction amount is adjusted to reflect the outcome of the vesting conditions, but no adjustment is made to the fair value of those equity instruments. That fair value is estimated at grant date (for transactions with employees and others providing similar services) and not subsequently revised. Hence, neither increases nor decreases in the fair value of the equity instruments after grant date are taken into account when determining the transaction amount (other than in the context of measuring the incremental fair value transferred if a grant of equity instruments is subsequently modified).

IG10 To apply these requirements, paragraph 20 of AASB 2 requires the entity to recognise the goods or services received during the vesting period based on the best available estimate of the number of equity instruments expected to vest and to revise that estimate, if necessary, if subsequent information indicates that the number of equity instruments expected to vest differs from previous estimates. On vesting date, the entity revises the estimate to equal the number of equity instruments that ultimately vested (subject to the requirements of paragraph 21 concerning market conditions).

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<sup>1</sup> In the remainder of this paragraph, the discussion of vesting conditions excludes market conditions, which are subject to the requirements of paragraph 21, AASB 2.

IG11 In the examples below, the share options granted all vest at the same time, at the end of a specified period. In some situations, share options or other equity instruments granted might vest in instalments over the vesting period. For example, suppose an employee is granted 100 share options, which will vest in instalments of 25 share options at the end of each year over the next four years. To apply the requirements of the Standard, the entity should treat each instalment as a separate share option grant, because each instalment has a different vesting period, and hence the fair value of each instalment will differ (because the length of the vesting period affects, for example, the likely timing of cash flows arising from the exercise of the options).

### IG Example 1

#### BACKGROUND

An entity grants 100 share options to each of its 500 employees. Each grant is conditional upon the employee working for the entity over the next three years. The entity estimates that the fair value of each share option is CU15<sup>2</sup>.

On the basis of a weighted average probability, the entity estimates that 20 per cent of employees will leave during the three-year period and therefore forfeit their rights to the share options.

#### APPLICATION OF REQUIREMENTS

##### Scenario 1

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

Year	Calculation	Remuneration expense for period CU	Cumulative remuneration expense CU
1	50,000 options × 80% × CU15 × 1/3 years	200,000	200,000
2	(50,000 options × 80% × CU15 × 2/3 years) – CU200,000	200,000	400,000
3	(50,000 options × 80% × CU15) – CU400,000	200,000	600,000
<i>continued</i>			

<sup>2</sup> In this example and in all other examples in this guidance, monetary amounts are denominated in 'currency units' (CU).

### Scenario 2

During year 1, 20 employees leave. The entity revises its estimate of total employee departures over the three-year period from 20 per cent (100 employees) to 15 per cent (75 employees). During year 2, a further 22 employees leave. The entity revises its estimate of total employee departures over the three-year period from 15 per cent to 12 per cent (60 employees). During year 3, a further 15 employees leave. Hence, a total of 57 employees forfeited their rights to the share options during the three-year period, and a total of 44,300 share options (443 employees × 100 options per employee) vested at the end of year 3.

Year	Calculation	Remuneration expense for period CU	Cumulative remuneration expense CU
1	50,000 options × 85% × CU15 × 1/3 years	212,500	212,500
2	(50,000 options × 88% × CU15 × 2/3 years) – CU212,500	227,500	440,000
3	(44,300 options × CU15) – CU440,000	224,500	664,500

IG12 In Example 1, the share options were granted conditionally upon the employees completing a specified service period. In some cases, a share option or share grant might also be conditional upon the achievement of a specified performance target. Examples 2, 3 and 4 illustrate the application of the Standard to share option or share grants with performance conditions (other than market conditions, which are discussed in paragraph IG13 and illustrated in Examples 5 and 6). In Example 2, the length of the vesting period varies, depending on when the performance condition is satisfied. Paragraph 15 of the Standard requires the entity to estimate the length of the expected vesting period, based on the most likely outcome of the performance condition, and to revise that estimate, if necessary, if subsequent information indicates that the length of the vesting period is likely to differ from previous estimates.

**IG Example 2**

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

**BACKGROUND**

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

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

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

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

**APPLICATION OF REQUIREMENTS**

Year	Calculation	Remuneration expense for period CU	Cumulative remuneration expense CU
1	440 employees × 100 shares × CU30 × 1/2 years	660,000	660,000
2	(417 employees × 100 shares × CU30 × 2/3 years) – CU660,000	174,000	834,000
3	(419 employees × 100 shares × CU30) – CU834,000	423,000	1,257,000



### **IG Example 3**

*Grant with a performance condition, in which the number of equity instruments varies*

#### **BACKGROUND**

At the beginning of year 1, Entity A grants share options to each of its 100 employees working in the sales department. The share options will vest at the end of year 3, provided that the employees remain in the entity's employ, and provided that the volume of sales of a particular product increases by at least an average of 5 per cent per year. If the volume of sales of the product increases by an average of between 5 per cent and 10 per cent per year, each employee will receive 100 share options. If the volume of sales increases by an average of between 10 per cent and 15 per cent each year, each employee will receive 200 share options. If the volume of sales increases by an average of 15 per cent or more, each employee will receive 300 share options.

On grant date, Entity A estimates that the share options have a fair value of CU20 per option. Entity A also estimates that the volume of sales of the product will increase by an average of between 10 per cent and 15 per cent per year, and therefore expects that, for each employee who remains in service until the end of year 3, 200 share options will vest. The entity also estimates, on the basis of a weighted average probability, that 20 per cent of employees will leave before the end of year 3.

By the end of year 1, seven employees have left and the entity still expects that a total of 20 employees will leave by the end of year 3. Hence, the entity expects that 80 employees will remain in service for the three-year period. Product sales have increased by 12 per cent and the entity expects this rate of increase to continue over the next 2 years.

By the end of year 2, a further five employees have left, bringing the total to 12 to date. The entity now expects only three more employees will leave during year 3, and therefore expects a total of 15 employees will have left during the three-year period, and hence 85 employees are expected to remain. Product sales have increased by 18 per cent, resulting in an average of 15 per cent over the two years to date. The entity now expects that sales will average 15 per cent or more over the three-year period, and hence expects each sales employee to receive 300 share options at the end of year 3.

*continued*

By the end of year 3, a further two employees have left. Hence, 14 employees have left during the three-year period, and 86 employees remain. The entity's sales have increased by an average of 16 per cent over the three years. Therefore, each of the 86 employees receives 300 share options.

#### APPLICATION OF REQUIREMENTS

Year	Calculation	Remuneration expense for period CU	Cumulative remuneration expense CU
1	80 employees × 200 options × CU20 × 1/3 years	106,667	106,667
2	(85 employees × 300 options × CU20 × 2/3 years) – CU106,667	233,333	340,000
3	(86 employees × 300 options × CU20) – CU340,000	176,000	516,000

#### IG Example 4

*Grant with a performance condition, in which the exercise price varies*

##### BACKGROUND

At the beginning of year 1, an entity grants to a senior executive 10,000 share options, conditional upon the executive remaining in the entity's employ until the end of year 3. The exercise price is CU40. However, the exercise price drops to CU30 if the entity's earnings increase by at least an average of 10 per cent per year over the three-year period.

On grant date, the entity estimates that the fair value of the share options, with an exercise price of CU30, is CU16 per option. If the exercise price is CU40, the entity estimates that the share options have a fair value of CU12 per option.

During year 1, the entity's earnings increased by 12 per cent, and the entity expects that earnings will continue to increase at this rate over the next two years. The entity therefore expects that the earnings target will be achieved, and hence the share options will have an exercise price of CU30.

During year 2, the entity's earnings increased by 13 per cent, and the entity continues to expect that the earnings target will be achieved.

*continued*

During year 3, the entity's earnings increased by only 3 per cent, and therefore the earnings target was not achieved. The executive completes three years' service, and therefore satisfies the service condition. Because the earnings target was not achieved, the 10,000 vested share options have an exercise price of CU40.

#### APPLICATION OF REQUIREMENTS

Because the exercise price varies depending on the outcome of a performance condition that is not a market condition, the effect of that performance condition (i.e. the possibility that the exercise price might be CU40 and the possibility that the exercise price might be CU30) is not taken into account when estimating the fair value of the share options at grant date. Instead, the entity estimates the fair value of the share options at grant date under each scenario (i.e. exercise price of CU40 and exercise price of CU30) and ultimately revises the transaction amount to reflect the outcome of that performance condition, as illustrated below.

Year	Calculation	Remuneration expense for period CU	Cumulative remuneration expense CU
1	10,000 options × CU16 × 1/3 years	53,333	53,333
2	(10,000 options × CU16 × 2/3 years) – CU53,333	53,334	106,667
3	(10,000 options × CU12) – CU106,667	13,333	120,000

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

**IG Example 5***Grant with a market condition***BACKGROUND**

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

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

**APPLICATION OF REQUIREMENTS**

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

Year	Calculation	Remuneration expense for period CU	Cumulative remuneration expense CU
1	10,000 options × CU24 × 1/3 years	80,000	80,000
2	(10,000 options × CU24 × 2/3 years) – CU80,000	80,000	160,000
3	(10,000 options × CU24) – CU160,000	80,000	240,000
<i>continued</i>			

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

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

#### **IG Example 6**

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

#### **BACKGROUND**

At the beginning of year 1, an entity grants 10,000 share options with a ten-year life to each of ten senior executives. The share options will vest and become exercisable immediately if and when the entity's share price increases from CU50 to CU70, provided that the executive remains in service until the share price target is achieved.

*continued*

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

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

#### APPLICATION OF REQUIREMENTS

Paragraph 15 of the Standard requires the entity to recognise the services received over the expected vesting period, as estimated at grant date, and also requires the entity not to revise that estimate. Therefore, the entity recognises the services received from the executives over years 1–5. Hence, the transaction amount is ultimately based on 70,000 share options (10,000 share options x 7 executives who remain in service at the end of year 5). Although another executive left during year 6, no adjustment is made, because the executive had already completed the expected vesting period of 5 years. Therefore, the entity recognises the following amounts in years 1 to 5.

Year	Calculation	Remuneration expense for period CU	Cumulative remuneration expense CU
1	80,000 options x CU25 x 1/5 years	400,000	400,000
2	(80,000 options x CU25 x 2/5 years) – CU400,000	400,000	800,000
3	(80,000 options x CU25 x 3/5 years) – CU800,000	400,000	1,200,000
4	(80,000 options x CU25 x 4/5 years) – CU1,200,000	400,000	1,600,000
5	(70,000 options x CU25) – CU1,600,000	150,000	1,750,000

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

**IG Example 7**

*Grant of share options that are subsequently repriced*

**BACKGROUND**

At the beginning of year 1, an entity grants 100 share options to each of its 500 employees. Each grant is conditional upon the employee remaining in service over the next three years. The entity estimates that the fair value of each option is CU15. On the basis of a weighted average probability, the entity estimates that 100 employees will leave during the three-year period and therefore forfeit their rights to the share options.

Suppose that 40 employees leave during year 1. Also suppose that by the end of year 1, the entity's share price has dropped, and the entity reprices its share options, and that the repriced share options vest at the end of year 3. The entity estimates that a further 70 employees will leave during years 2 and 3, and hence the total expected employee departures over the three-year vesting period is 110 employees. During year 2, a further 35 employees leave, and the entity estimates that a further 30 employees will leave during year 3, to bring the total expected employee departures over the three-year vesting period to 105 employees. During year 3, a total of 28 employees leave, and hence a total of 103 employees ceased employment during the vesting period. For the remaining 397 employees, the share options vested at the end of year 3.

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

*continued*

#### APPLICATION OF REQUIREMENTS

Paragraph 27 of the Standard requires the entity to recognise the effects of modifications that increase the total fair value of the share-based payment arrangement or are otherwise beneficial to the employee. If the modification increases the fair value of the equity instruments granted (e.g. by reducing the exercise price), measured immediately before and after the modification, paragraph B43(a) of Appendix B requires the entity to include the incremental fair value granted (i.e. the difference between the fair value of the modified equity instrument and that of the original equity instrument, both estimated as at the date of the modification) in the measurement of the amount recognised for services received as consideration for the equity instruments granted. If the modification occurs during the vesting period, the incremental fair value granted is included in the measurement of the amount recognised for services received over the period from the modification date until the date when the modified equity instruments vest, in addition to the amount based on the grant date fair value of the original equity instruments, which is recognised over the remainder of the original vesting period.

The incremental value is CU3 per share option (CU8 – CU5). This amount is recognised over the remaining two years of the vesting period, along with remuneration expense based on the original option value of CU15.

The amounts recognised in years 1 – 3 are as follows.

Year	Calculation	Remuneration expense for period CU	Cumulative remuneration expense CU
1	(500 – 110) employees × 100 options × CU15 × 1/3 years	195,000	195,000
2	[(500 – 105) employees × 100 options × (CU15 × 2/3 years + CU3 × 1/2 years)] – CU195,000	259,250	454,250
3	[(500 – 103) employees × 100 options × (CU15 + CU3)] – CU454,250	260,350	714,600



**IG Example 8**

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

**BACKGROUND**

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

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

**APPLICATION OF REQUIREMENTS**

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

*continued*

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

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

#### **IG Example 9**

*Grant of shares, with a cash alternative subsequently added*

##### **BACKGROUND**

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

##### **APPLICATION OF REQUIREMENTS**

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

*continued*

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

Year	Calculation	Expense CU	Equity CU	Liability CU
1	Remuneration expense for year: $10,000 \text{ shares} \times \text{CU}33 \times \frac{1}{3} \text{ years}$	110,000	110,000	
2	Remuneration expense for year: $(10,000 \text{ shares} \times \text{CU}33 \times \frac{2}{3} \text{ years}) - \text{CU}110,000$ Reclassify equity to liabilities: $10,000 \text{ shares} \times \text{CU}25 \times \frac{2}{3} \text{ years}$	110,000	110,000  (166,667)	  166,667
3	Remuneration expense for year: $(10,000 \text{ shares} \times \text{CU}33) - \text{CU}220,000$ Adjust liability to closing fair value: $(\text{CU}166,667 + \text{CU}83,333) - (\text{CU}22 \times 10,000 \text{ shares})$	110,000  (30,000)	26,667	83,333*  (30,000)
	Total	300,000	80,000	220,000
* Allocated between liabilities and equity to bring in the final third of the liability based on the fair value of the shares as at the date of the modification.				

IG16 Paragraph 24 of the Standard requires that, in rare cases only, in which the Standard requires the entity to measure an equity-settled share-based payment transaction by reference to the fair value of the equity instruments granted, but the entity is unable to estimate reliably that fair value at the specified measurement date (e.g. grant date, for transactions with employees), the entity shall instead measure the transaction using an intrinsic value measurement method. Paragraph 24 also contains requirements on how to apply this method. The following example illustrates these requirements.

**IG Example 10**

*Grant of share options that is accounted for by applying the intrinsic value method*

**BACKGROUND**

At the beginning of year 1, an entity grants 1,000 share options to 50 employees. The share options will vest at the end of year 3, provided the employees remain in service until then. The share options have a life of 10 years. The exercise price is CU60 and the entity's share price is also CU60 at the date of grant.

At the date of grant, the entity concludes that it cannot estimate reliably the fair value of the share options granted.

At the end of year 1, three employees have ceased employment and the entity estimates that a further seven employees will leave during years 2 and 3. Hence, the entity estimates that 80 per cent of the share options will vest.

Two employees leave during year 2, and the entity revises its estimate of the number of share options that it expects will vest to 86 per cent.

Two employees leave during year 3. Hence, 43,000 share options vested at the end of year 3.

The entity's share price during years 1 – 10, and the number of share options exercised during years 4 – 10, are set out below. Share options that were exercised during a particular year were all exercised at the end of that year.

Year		Share price at year-end	Number of share options exercised at year-end
1		63	0
2		65	0
3		75	0
4		88	6,000
5		100	8,000
6		90	5,000
7		96	9,000
8		105	8,000
9		108	5,000
10		115	2,000

*continued*

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

IG17 There are many different types of employee share and share option plans. The following example illustrates the application of AASB 2 to one particular type of plan – an employee share purchase plan. Typically, an employee share purchase plan provides employees with the opportunity to purchase the entity's shares at a discounted price. The terms and conditions under which employee share purchase plans

operate differ from country to country. That is to say, not only are there many different types of employee share and share options plans, there are also many different types of employee share purchase plans. Therefore, the following example illustrates the application of AASB 2 to one specific employee share purchase plan.

### **IG Example 11**

#### *Employee share purchase plan*

#### **BACKGROUND**

An entity offers all its 1,000 employees the opportunity to participate in an employee share purchase plan. The employees have two weeks to decide whether to accept the offer. Under the terms of the plan, the employees are entitled to purchase a maximum of 100 shares each. The purchase price will be 20 per cent less than the market price of the entity's shares at the date the offer is accepted, and the purchase price must be paid immediately upon acceptance of the offer. All shares purchased must be held in trust for the employees, and cannot be sold for five years. The employee is not permitted to withdraw from the plan during that period. For example, if the employee ceases employment during the five-year period, the shares must nevertheless remain in the plan until the end of the five-year period. Any dividends paid during the five-year period will be held in trust for the employees until the end of the five-year period.

In total, 800 employees accept the offer and each employee purchases, on average, 80 shares, that is, the employees purchase a total of 64,000 shares. The weighted average market price of the shares at the purchase date is CU30 per share, and the weighted average purchase price is CU24 per share.

#### **APPLICATION OF REQUIREMENTS**

For transactions with employees, AASB 2 requires the transaction amount to be measured by reference to the fair value of the equity instruments granted (AASB 2, paragraph 11). To apply this requirement, it is necessary first to determine the type of equity instrument granted to the employees. Although the plan is described as an employee share purchase plan (ESPP), some ESPPs include option features and are therefore, in effect, share option plans. For example, an ESPP might include a 'lookback feature', whereby the employee is able to purchase shares at a discount, and choose whether the discount is applied to the entity's share price at the date of grant or its share price at the date of purchase. Or an ESPP might specify the purchase price, and then allow the employees a significant period of time to decide whether to participate in the plan.

*continued*

Another example of an option feature is an ESPP that permits the participating employees to cancel their participation before or at the end of a specified period and obtain a refund of amounts previously paid into the plan.

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

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

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

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

However, in some cases, the expense relating to an ESPP might not be material. AASB 108 *Accounting Policies, Changes in Accounting Policies and Errors* states that the accounting policies in Standards need not be applied when the effect of applying them is immaterial (AASB 108, paragraph 8). AASB 108 also states that an omission or misstatement of an item is material if it could, individually or collectively, influence the economic decisions of users taken on the basis of the financial report. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor (AASB 108, paragraph 5). Therefore, in this example, the entity should consider whether the expense of CU256,000 is material.

## Cash-settled share-based payment transactions

- IG18 Paragraphs 30-33 of the Standard set out requirements for transactions in which an entity acquires goods or services by incurring liabilities to the supplier of those goods or services in amounts based on the price of the entity's shares or other equity instruments. The entity is required to recognise initially the goods or services acquired, and a liability to pay for those goods or services, when the entity obtains the goods or as the services are rendered, measured at the fair value of the liability. Thereafter, until the liability is settled, the entity is required to recognise changes in the fair value of the liability.
- IG19 For example, an entity might grant share appreciation rights to employees as part of their remuneration package, whereby the employees will become entitled to a future cash payment (rather than an equity instrument), based on the increase in the entity's share price from a specified level over a specified period of time. If the share appreciation rights do not vest until the employees have completed a specified period of service, the entity recognises the services received, and a liability to pay for them, as the employees render service during that period. The liability is measured, initially and at each reporting date until settled, at the fair value of the share appreciation rights, by applying an option pricing model, and the extent to which the employees have rendered service to date. Changes in fair value are recognised in profit or loss. Therefore, if the amount recognised for the services received was included in the carrying amount of an asset recognised in the entity's balance sheet (e.g. inventory), the carrying amount of that asset is not adjusted for the effects of the liability remeasurement. Example 12 illustrates these requirements.

### IG Example 12

#### BACKGROUND

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

During year 1, 35 employees leave. The entity estimates that a further 60 will leave during years 2 and 3. During year 2, 40 employees leave and the entity estimates that a further 25 will leave during year 3. During year 3, 22 employees leave. At the end of year 3, 150 employees exercise their SARs, another 140 employees exercise their SARs at the end of year 4 and the remaining 113 employees exercise their SARs at the end of year 5.

*continued*



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

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

  

APPLICATION OF REQUIREMENTS				
Year	Calculation		Expense CU	Liability CU
1	(500 – 95) employees × 100 SARs × CU14.40 × 1/3 years		194,400	194,400
2	(500 – 100) employees × 100 SARs × CU15.50 × 2/3 years – CU194,400		218,933	413,333
3	(500 – 97 – 150) employees × 100 SARs × CU18.20 – CU413,333	47,127		460,460
	+ 150 employees × 100 SARs × CU15.00	<u>225,000</u>		
	Total		272,127	
4	(253 – 140) employees × 100 SARs × CU21.40 – CU460,460 + 140 employees × 100 SARs × CU20.00	(218,640)		241,820
	Total	<u>280,000</u>	61,360	
5	0 employees × 100 SARs × CU25.00 – CU241,820 + 113 employees × 100 SARs × CU25.00	(241,820)		0
	Total	<u>282,500</u>	<u>40,680</u>	
	Total		<u>787,500</u>	

## Share-based payment arrangements with cash alternatives

- IG20 Some employee share-based payment arrangements permit the employee to choose whether to receive cash or equity instruments. In this situation, a compound financial instrument has been granted, that is, a financial instrument with debt and equity components. Paragraph 37 of the Standard requires the entity to estimate the fair value of the compound financial instrument at grant date, by first measuring the fair value of the debt component, and then measuring the fair value of the equity component – taking into account that the employee must forfeit the right to receive cash to receive the equity instrument.
- IG21 Typically, share-based payment arrangements with cash alternatives are structured so that the fair value of one settlement alternative is the same as the other. For example, the employee might have the choice of receiving share options or cash share appreciation rights. In such cases, the fair value of the equity component will be zero, and hence the fair value of the compound financial instrument will be the same as the fair value of the debt component. However, if the fair values of the settlement alternatives differ, usually the fair value of the equity component will be greater than zero, in which case the fair value of the compound financial instrument will be greater than the fair value of the debt component.
- IG22 Paragraph 38 of the Standard requires the entity to account separately for the services received in respect of each component of the compound financial instrument. For the debt component, the entity recognises the services received, and a liability to pay for those services, as the counterparty renders service, in accordance with the requirements applying to cash-settled share-based payment transactions. For the equity component (if any), the entity recognises the services received, and an increase in equity, as the counterparty renders service, in accordance with the requirements applying to equity-settled share-based payment transactions. Example 13 illustrates these requirements.

### IG Example 13

#### BACKGROUND

An entity grants to an employee the right to choose either 1,000 phantom shares, that is, a right to a cash payment equal to the value of 1,000 shares, or 1,200 shares. The grant is conditional upon the completion of three years' service. If the employee chooses the share alternative, the shares must be held for three years after vesting date.

*continued*

At grant date, the entity's share price is CU50 per share. At the end of years 1, 2 and 3, the share price is CU52, CU55 and CU60 respectively. The entity does not expect to pay dividends in the next three years. After taking into account the effects of the post-vesting transfer restrictions, the entity estimates that the grant date fair value of the share alternative is CU48 per share.

At the end of year 3, the employee chooses:

Scenario 1: The cash alternative

Scenario 2: The equity alternative

#### APPLICATION OF REQUIREMENTS

The fair value of the equity alternative is CU57,600 (1,200 shares × CU48). The fair value of the cash alternative is CU50,000 (1,000 phantom shares × CU50). Therefore, the fair value of the equity component of the compound instrument is CU7,600 (CU57,600 – CU50,000).

The entity recognises the following amounts.

Year	Calculation	Expense CU	Equity CU	Liability CU
1	Liability component: (1,000 × CU52 × 1/3 years) Equity component: (CU7,600 × 1/3 years)	17,333 2,533	 2,533	17,333
2	Liability component: (1,000 × CU55 × 2/3 years) – CU17,333 Equity component: (CU7,600 × 1/3 years)	19,333 2,533	 2,533	19,333
3	Liability component: (1,000 × CU60) – CU36,666 Equity component: (CU7,600 × 1/3 years)	23,334 2,534	 2,534	23,334
End Year 3	Scenario 1: cash of CU60,000 paid Scenario 1 totals Scenario 2: 1,200 shares issued Scenario 2 totals	 <u>67,600</u>  <u>67,600</u>	 <u>7,600</u> 60,000 <u>67,600</u>	(60,000) <u>0</u> (60,000) <u>0</u>

## Illustrative disclosures

IG23 The following example illustrates the disclosure requirements in paragraphs 44-52 of the Standard<sup>3</sup>.

<i>Extract from the Notes to the Financial Statements of Company Z for the year ended 31 December 2005.</i>				
<b>Share-based Payment</b>				
During the period ended 31 December 2005, the Company had four share-based payment arrangements, which are described below.				
Type of arrangement	Senior management share option plan	General employee share option plan	Executive share plan	Senior management share appreciation cash plan
Date of grant	1 January 2004	1 January 2005	1 January 2005	1 July 2005
Number granted	50,000	75,000	50,000	25,000
Contractual life	10 years	10 years	N/A	10 years
Vesting conditions	1.5 years' service and achievement of a share price target, which was achieved	Three years' service	Three years' service and achievement of a target growth in earnings per share	Three years' service and achievement of a target increase in market share
<i>continued</i>				

<sup>3</sup> Note that the illustrative example is not intended to be a template or model and is therefore not exhaustive. For example, it does not illustrate the disclosure requirements in paragraphs 47(c), 48 and 49 of AASB 2.

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

The estimated fair value of each share granted in the executive share plan is CU50.00, which is equal to the share price at the date of grant.

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

	2004		2005	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Outstanding at start of year	0	–	45,000	CU40
Granted	50,000	CU40	75,000	CU50
Forfeited	(5,000)	CU40	(8,000)	CU46
Exercised	0	–	(4,000)	CU40
Outstanding at end of year	45,000	CU40	108,000	CU46
Exercisable at end of year	0	CU40	38,000	CU40

The weighted average share price at the date of exercise for share options exercised during the period was CU52. The options outstanding at 31 December 2005 had an exercise price of CU40 or CU50, and a weighted average remaining contractual life of 8.64 years.

	2004 CU	2005 CU
Expense arising from share-based payment transactions	495,000	1,105,867
Expense arising from share and share option plans	495,000	1,007,000
Closing balance of liability for cash share appreciation plan	–	98,867
Expense arising from increase in fair value of liability for cash share appreciation plan	–	9,200