International Accounting Standards Board®

Press Release

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IASB ISSUES STANDARD ON SHARE-BASED PAYMENT

The International Accounting Standards Board (IASB) today issued International Financial Reporting Standard 2 *Share-based Payment* (IFRS 2) on accounting for share-based payment transactions, including grants of share options to employees.

Recent events have emphasised the importance of high quality financial statements that provide neutral, transparent and comparable information to help users make economic decisions. However, before the issue of IFRS 2, there was no international accounting standard covering the recognition or measurement of share-based payment, the use of which has expanded greatly in recent years. In particular, the omission of expenses arising from share-based payment transactions with employees has been highlighted by investors, other users of financial statements and other commentators as causing economic distortions and corporate governance concerns. The issue of IFRS 2 fills this gap in international standards.

The objective of IFRS 2 is to specify the financial reporting by an entity when it undertakes a share-based payment transaction. In particular, the IFRS 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.

Introducing the exposure draft, Sir David Tweedie, IASB Chairman, said:

> "This standard addresses an area of accounting that has been a concern to users of financial statements for some time. Recently, those concerns increased substantially, when major corporate failures demonstrated the importance of transparent, unbiased and complete financial statements. In particular, investors and others have highlighted the need for proper accounting for employee share options. Typically,

transactions in which share options are granted to employees are not recognised in an entity's financial statements. As a result, the entity's expenses are understated and its profits are overstated, which is potentially misleading to users of financial statements. The objective of IFRS 2 is to require that, no matter what form of remuneration is used, the entity recognises the associated expenses. In this way, IFRS 2 will improve the quality of financial reporting by giving a clearer and more complete picture of an entity's activities, which will assist investors and other users of financial statements to make informed economic decisions."

Copies of IFRS 2 *Share-based Payment* (ISBN 1-904230-40-7) are available, at £15 each (€24/US$23) including postage, from:
IASB Publications Department, 30 Cannon Street, London EC4M 6XH, United Kingdom.
Tel: +44 (0)20 7332-2730, Fax: +44 (0)20 7332 2749,
email: publications@iasb.org Web: www.iasb.org
Subscribers to the IASB's *Comprehensive Subscription Service* can view the IFRS from the secure subscriber area of the IASB's Website.

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Press enquiries:

Sir David Tweedie, Chairman, IASB,
telephone: +44 (0)20 7246 6410, email: mailto:dtweedie@iasb.org

Thomas Jones, Vice-Chairman, IASB
telephone: +1 203 834 7490, email: tjones@iasb.org

Kevin Stevenson, Director of Technical Activities, IASB,
telephone: +44 (0)20 7246 6460, email: kstevenson@iasb.org

Wayne Upton, Director of Research, IASB,
telephone: +44 (0)20 7246 6410, email: wupton@iasb.org

Kimberley Crook, Senior Project Manager, IASB
Telephone: +44 (0)20 7246 6434, email: kcrook@iasb.org

NOTES TO EDITORS

Summary of IFRS 2

1. The main requirements of IFRS 2 are:

    - The IFRS requires an entity to recognise share-based payment transactions in its financial statements, including transactions with employees or other parties to be settled in cash, other assets, or equity instruments of the entity. There are no exceptions to the IFRS, other than for transactions to which other Standards apply.

    - In principle, transactions in which goods or services are received as consideration for equity instruments of the entity should be measured 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 is required to measure the transaction by reference to the fair value of the equity instruments granted.

    - For transactions with employees and others providing similar services, the entity is required to measure the fair value of the equity instruments granted, because it is typically not possible to estimate reliably the fair value of employee services received. The fair value of the equity instruments granted is measured at grant date.

    - For transactions with other parties (ie other than employees and those providing similar services), there is a rebuttable presumption that the fair value of the goods or services received can be estimated reliably. That fair value is measured at the date the entity obtains the goods or the counterparty renders service. In rare cases, if the presumption is rebutted, the transaction is measured 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.

    - For goods or services measured by reference to the fair value of the equity instruments granted, the IFRS specifies that, in general, vesting conditions are not taken into account when estimating the fair value of the shares or options at the relevant measurement date (as specified above). 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.

    - The IFRS requires the fair value of equity instruments granted to be based on market prices, if available, and to take into account the terms and conditions upon which those equity instruments were granted. In the absence of market prices, fair value is estimated, 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 IFRS also sets out requirements if the terms and conditions of an option or share grant are modified (eg an option is repriced) or if a grant is cancelled, repurchased or replaced with another grant of equity instruments.

    - For cash-settled share-based payment transactions, the IFRS requires an entity to measure the goods or services acquired and the liability incurred at the fair value of the liability. Until the liability is settled, the entity is required to remeasure the fair value of the liability at each reporting date and at the date of settlement, with any changes in value recognised in profit or loss for the period.

- The IFRS also sets out requirements for share-based payment transactions in which the terms of the arrangement provide either the entity or the supplier of goods or services with a choice of whether the entity settles the transaction in cash or by issuing equity instruments.

- The IFRS prescribes various disclosure requirements to enable users of financial statements to understand:

  (a) the nature and extent of share-based payment arrangements that existed during the period;

  (b) how the fair value of the goods or services received, or the fair value of the equity instruments granted, during the period was determined; and

  (c) the effect of share-based payment transactions on the entity's profit or loss for the period and on its financial position.

2. Before the issue of IFRS 2, there was no existing International Financial Reporting Standard on the recognition or measurement of share-based payment. The requirements in IFRS 2 replace the disclosure requirements in IAS 19 *Employee Benefits* that deal with equity compensation benefits.

3. As with IFRS 1, the IASB is publishing IFRS 2 as three separate booklets. The first contains the mandatory requirements of the IFRS; the second contains the IASB's Basis for Conclusions, which sets out the IASB's reasoning behind the requirements in the IFRS; and the third consists of implementation guidance, including various illustrative examples.

Summary of due process

4. In July 2000, IASC (the IASB's predecessor body), along with other members of the G4+1 group,[*] published for public comment a Discussion Paper *Accounting for Share-based Payment.* In July 2001, the IASB added a project on share-based payment to its agenda, and agreed that the product of the first stage of the project should be the development of an Exposure Draft of an IFRS. In September 2001, the IASB invited additional comments by 15 December 2001 on the IASC/G4+1 Discussion Paper. The IASB considered the comments received when developing an exposure draft and received input from its Standards Advisory Council (SAC). Furthermore, the IASB was assisted by the project's Advisory Group, consisting of individuals from various countries and with a range of backgrounds, including people from the investment, corporate, audit, academic, compensation consultancy, valuation, and regulatory communities. The IASB received further assistance from other experts at a panel discussion held in New York City in July 2002. In November 2002, the Board published an Exposure Draft, ED 2 *Share-based Payment*, with a comment deadline of 7 March 2003. The Board considered the comments received in finalising IFRS 2, and received further input from SAC. The Board also worked with the Financial Accounting Standards Board (FASB) after that body added to its agenda a project to review US accounting requirements on share-based payment. This included

[*] The G4+1 comprised members of the national accounting standard-setting bodies of Australia, Canada, New Zealand, the UK and the US, and IASC.

participating in meetings of the FASB's Option Valuation Group and meeting the FASB to discuss convergence issues.

About the IASB

5. The IASB, based in London, began operations in 2001. It is funded by contributions collected by its Trustees, the IASC Foundation, from the major accounting firms, private financial institutions and industrial companies throughout the world, central and development banks, and other international and professional organisations. The 14 IASB members (12 of whom are full-time) reside in nine countries and have a variety of professional backgrounds. The IASB is committed to developing, in the public interest, a single set of high quality, global accounting standards that require transparent and comparable information in general purpose financial statements. In pursuit of this objective, the IASB cooperates with national accounting standard-setters to achieve convergence in accounting standards around the world.