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International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting:	**18 July 2006, London**
Project:	**IFRS 2**
Subject:	**Exposure Draft – Vesting Conditions and Cancellations (Agenda Paper 6) – Cover Paper**

INTRODUCTION

1. At a previous meeting, the IASB agreed proposed amendments to IFRS 2 in respect of the treatment of cancellations and the definition of vesting conditions.

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

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

4. These issues were considered by the International Financial Reporting Interpretations Committee (IFRIC) in its draft Interpretation D11 *Changes in Contributions to Employee Share Purchase Plans*, which was published for comment in December 2004. However, the IFRIC was subsequently unable to reach a consensus and the issues were referred to the Board.

5. The Board agreed with the IFRIC that these issues should be clarified. After further deliberation, the Board agreed that all cancellations, whether by the entity or by other parties, should be treated the same and that vesting conditions are service or performance conditions only.

6. The Exposure Draft of the proposed amendment to IFRS 2 was published for comment on 2 February 2006. The comment period ended on 2 June. In total, the Board received comment letters from 56 respondents, including preparers, accounting firms, analysts and standard setters. This paper summarises the comments received on the proposed amendments to IFRS 2.

7. Most respondents agreed that the issues dealt with in the Exposure Draft need to be addressed and welcomed guidance in this area. Also, most agreed with the proposed amendment to the definition of vesting conditions, subject to some additional clarification. However, a small majority (55%) of respondents disagreed with the proposed treatment of cancellations either on the grounds that all cancellations are not the same in substance or because cancellations by employees in certain types of plans should be treated differently.

8. The significant comments received relate primarily to the following issues and are summarised in subsequent paragraphs:

   (a) the definition of a performance-related vesting condition;

   (b) the definition and treatment of cancellations by counterparties;

   (c) consistency with FAS 123 (revised 2004);

   (d) transition requirements.

9. This paper outlines the staff's summary in respect of the key issues raised. In addition, two of these issues are discussed in greater detail in papers 6A: (Performance conditions) and 6B: (Cancellations).

SUMMARY OF COMMENTS RECEIVED

Vesting conditions

10. Most respondents agreed with the restriction of vesting conditions to service and performance conditions only. However some respondents asked for further clarification of the definition of a performance condition. For example, does the performance relate only to performance by the entity and could it include factors that are unrelated to the performance of either the entity or the employee eg a commodity index?

11. These issues are discussed further in paper 6A.

Cancellations

12. Most of the comments submitted by respondents were in respect of the Board's decision to require the same accounting treatment for all cancellations.

13. About half of the respondents disagreed with the Board's proposals. The key points raised in respect of the proposed treatment for counterparty cancellations were:

    (a) Cancellations by counterparties and cancellations by an entity are economically different and should be accounted for differently;

    (b) There should be an exemption for certain types of plans;

    (c) The incorporation of the probability of cancellation in the grant date fair value is highly subjective and could be very difficult;

    (d) Further guidance on the definition of a cancellation is required.

14. These issues are discussed further in paper 6B.

Consistency with FAS 123 (revised 2004)

15. Some respondents noted that the requirements of FAS 123 (revised 2004) are sometimes unclear. Other respondents noted that the other areas of divergence between FAS 123 (revised 2004) and IFRS 2 means that differences in the

accounting for certain types of transactions remain, in spite of the convergence on specific issues in the Exposure Draft.

16. These issues will be discussed in a subsequent paper.

Transition requirements

17. Three respondents disagreed with the retrospective application of the proposals on the grounds that the amount of work involved in the data collection and recalculation of the charge outweighs the benefits that will be achieved by restating the comparatives. One respondent noted that this problem is exacerbated by the fact that many of the share plans that would be affected by the proposed amendments are outsourced to third party administrators. These administrators are unlikely to know the reason that the employees ceased contributions to the plan.

18. These issues will be discussed in a subsequent paper.

Summary of Staff Recommendations

The staff recommends the following:

(a) The Board's proposal in respect of restricting the definition of vesting conditions to service conditions and performance conditions should be included in a final amendment to IFRS 2. (Paper 6A).

(b) A limited amount of additional research should be conducted to determine whether guidance could be given on making a distinction between a cancellation by an entity and a cancellation by a counterparty. (Paper 6B).

(c) The amendment should apply to all share-based payment transactions that fall within the scope of IFRS 2. (Paper 6B).

(d) The proposal to include the probability of counterparty cancellation in the calculation of the fair value of equity instruments issued should be included in the final amendment to IFRS 2. (Paper 6B).

(e) The Board should give some further guidance, as an addition to the Implementation Guidance for IFRS 2, on the accounting treatment of the conditions that determine whether a counterparty obtains the equity instruments granted. This could take the form of a simple organisation chart or table and should not necessitate re-exposure of the proposed amendments. (Paper 6B).