30 Cannon Street, London EC4M 6XH, United Kingdom
Tel: +44 (0)20 7246 6410 Fax: +44 (0)20 7246 6411
Email: iasb@iasb.org Website: www.iasb.org

International Accounting Standards Board

This document is provided as a convenience to observers at IASB meetings, to assist them in following the Board's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.
These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

Board Meeting:	**17 July 2007, London**
Project:	**IFRS 2 *Share-based Payments***
Subject:	**Vesting Conditions and Cancellations – the grant date (Agenda paper 9)**

Objective

1. The objective of this paper is to determine whether the Board wishes to clarify its views on the definition of grant date before finalising the proposed Amendment to IFRS 2 – *Vesting Conditions and Cancellations*.

Background

2. At the May meeting, the Board agreed to finalise its Amendment to IFRS 2 – *Vesting Conditions and Cancellation* and directed the staff to prepare a ballot draft of the Amendment.

3. In response to the ballot draft, one Board member indicated that a fuller discussion of how the grant date should be determined under IFRS 2 would be useful. In particular, that Board member disagreed with the way in which it appears that the grant date is commonly interpreted under IFRS 2.

4. The definition of grant date was not addressed by the proposed amendment to IFRS 2. However, it was discussed at the May meeting because there is an important interaction between the determination of the grant date and the proposed cancellation requirements. A cancellation cannot occur before the grant

date and since the grant dates in IFRS 2 and SFAS 123(R) could be different, the same event could be treated as a reversal of expense by one standard (because grant date has not yet occurred) and an acceleration of expense by the other standard (because grant date has occurred).

5. At the May meeting, the Board acknowledged this difference but noted that the issue already exists for cancellations by the entity – the proposed amendment addresses cancellations by the counterparty only. Also there are more significant differences between IFRS 2 and SFAS 123(R). For example, SFAS 123(R) does not include within its scope share-based payment transactions with non-employees. Finally, the Board noted that it had previously decided to consider a second phase of work on convergence of the two standards after the project on distinguishing between liabilities and equity is completed. The Board therefore decided that any further work in respect of the determination of the grant date should be considered as part of that second phase.

6. The staff notes, further, that any deliberations by the Board in respect of the grant date could be completed independently of finalising the Amendment. However, for completeness, and given that the issue has been raised a second time, the staff has set out in this paper the key issues that have arisen in respect of the determination of the grant date.

Staff Recommendation

7. The staff recommends that the IASB proceeds with the proposed Amendment to IFRS 2, as ballotted.

8. The Implementation Guidance of IFRS 2 already includes some explanatory guidance on the determination of the grant date. Therefore, the staff recommends that the Board does not add any further guidance on this in advance of the second phase of work on share-based payments.

The grant date - interpretations of ‘shared understanding’

9. IFRS 2 and SFAS 123 (r) have very similar definitions of grant date. Both definitions state that a grant date only occurs when there is a mutual /shared understanding of the terms and conditions of the share-based payment.

10. However, the meaning of “a shared understanding” of the terms and conditions might be unclear in some circumstances.

11. In developing IFRS 2, the IASB concluded that determining when grant date occurs will require an assessment of the specific circumstances of each case, and that assessment will require the exercise of judgement. However, the Board decided to provide some further explanatory guidance in the Implementation Guidance of IFRS 2 to clarify the definition of a grant date.

12. This guidance confirms that if an exercise price must be set by a compensation committee or an award is subject to shareholder approval, then no shared understanding of the terms and conditions of the option grant has occurred until such time as the entity's compensation committee sets the exercise price or shareholder approval is obtained.

13. The FASB initially concluded that a mutual understanding of the terms and conditions means that the counterparty should be able to determine or reasonably estimate the fair value of the equity instruments under the modified grant date approach, which is not possible until the exercise price is set. Some constituents expressed reservations about this approach and the FASB later concluded that grant date does not occur until the counterparty begins to benefit from, or be adversely affected by, subsequent changes in the price of the entity's shares.

14. These two interpretations means that a share-based payment award would often have the same grant date under both standards. Consider the following example:

    Example 1

    On January 1 2007, an entity enters into an employment contract with its chief executive officer (CEO) to issue 100,000 share-based payment awards on 31 December 2010 if the CEO is still in service at that date.
    The exercise price will be set by a compensatory committee on 1 January 2010.

15. Under both IFRS 2 and SFAS 123 (r), the grant date does not occur until 1 January 2010 when the exercise price is set by the compensation committee.

16. Consider the next example. This is the same as Example 1 except that the exercise price is set equal to the lower of the share price on 1 January 2007 and the share price on 1 January 2010.

    Example 2

    On January 1 2007, an entity enters into an employment contract with its chief executive officer (CEO) to issue 100,000 share-based payment awards on 31 December 2010.

The exercise price will be set as the lower of the share price on 1 January 2007 and the share price on 1 January 2010.

17. Under both IFRS 2 and SFAS 123 (r), the grant date is 1 January 2007.

18. There are cases however where there appear to be divergent interpretations in practice of the grant date under IFRS 2 and SFAS 123 (r). Consider the next example. This is the same as Example 1 except that the exercise price is equal to the share price at the issue date:

Example 3

On 1 January 2007, an entity enters into an employment contract with its chief executive officer (CEO) to issue 100,000 share-based payment awards on 31 December 2010.

The exercise price will be set equal to the share price on 1 January 2010.

19. It is not necessary for the exercise price to be known in order for a grant date to have occurred in accordance with IFRS 2. It would suffice to have an understanding of how the exercise price would be determined. In this case, it is clear how the exercise price is determined so the grant date is 1 January 2007.

20. In accordance with paragraph A78 of SFAS 123 (r), the grant date does not occur until 1 January 2010 because the counterparty does not begin to benefit from, or be adversely affected by, changes in the price of the entity's shares until that date.

21. The staff notes that the requirement for the counterparty to be able to benefit from, or be adversely affected by, future share price changes in order for a grant date to have occurred, would exclude some share-based payments that are currently thought to be within the scope of IFRS 2.

22. In March 2006, the IFRIC considered whether an employee share plan in which the employer had the choice of settlement in cash or in shares, and the amount of the settlement did not vary with changes in the share price of the entity should be treated as a share-based payment transaction within the scope of IFRS 2 Share-based Payment.

For example,

- Company X agrees to pay employees a bonus based on performance criteria which are not directly linked to its share price.
- The arrangement provides Company X with a choice of settlement, either in cash or in shares with value equivalent to the value of the cash payment.

23. The following excerpt is taken from IFRIC reasons for not taking this project onto its agenda in May 2006.

> "The IFRIC noted that the definition of a share-based payment transaction does not require the exposure of the entity to be linked to movements in the share price of the entity. Moreover, it is clear that IFRS 2 contemplates share-based payment transactions in which the terms of the arrangement provide the entity with a choice of settlement, since they are specifically addressed in paragraphs 41 - 43 of IFRS 2.
>
> The IFRIC, therefore, believed that, although the amount of the settlement did not vary with changes in the share price of the entity, such share plans are share-based payment transactions in accordance with IFRS 2 since the consideration may be equity instruments of the entity.
>
> The IFRIC also believed that, even in the extreme circumstances in which the entity was given a choice of settlement and the value of the shares that would be delivered was a fixed monetary amount, those share plans were still within the scope of IFRS 2."

24. Further, the staff thinks that some may disagree with the presumption that the counterparty does not begin to benefit from, or be adversely affected by, changes in the entity's share price until 2010, because the exercise price has not yet been set.

25. The award in Example 3 is an example of a forward start option. Many would argue that as at 1 January 2007, the expectation of volatility of the share price between 2007 and 2010 does affect the value of the award that has been granted. This is independent of the exercise price. Therefore, it is arguable that the counterparty does begin to benefit from, or be adversely affected by, changes in the entity's share price before the exercise price is set.

26. The staff acknowledges, however, that some may also disagree with the IFRS 2 interpretation of a 'shared understanding'. For instance, consider the following example:

Example 4

On 1 January 2007, an entity enters into an employment contract with its chief executive officer (CEO) to issue 10,000 shares on 31 December of every year starting 31 December 2008 until retirement. The CEO has 20 years to retirement. The exercise price will be set equal to the share price on 1 January of the year in which the shares are awarded.

27. Under IFRS 2, a shared understanding of the terms and conditions is achieved at 1 January 2007, so there would be a single grant date for all the awards. However

each successive tranche would have a successively longer vesting period. For instance the tranche issued in 2009 would have a vesting period of 3 years, the tranche in 2010, 4 years and so on.

28. Under SFAS 123 (r), there will be multiple grant dates, with each tranche being deemed to have been granted on 1 January of each year when the exercise price is set. So, the tranche paid in 2009 would have a grant date of 1 January 2009 and a vesting period of 1 year, the tranche paid in 2010, would have a grant date of 1 January 2010 and a vesting period of 1 year, and so on.

29. The staff notes, also, that it would be difficult to distinguish between the award in Example 4 and an award of 200,000 shares (20 x 10,000) that vests in annual instalments of 10,000 for each of the next 20 years.

30. If the plan were described as vesting in instalments, IG 11 would require the entity to treat each annual instalment as a separate grant which will vest at the end of each successive year. This would give the same result as if the determination of the grant date followed the IFRS 2 interpretation. Therefore the staff favours the IFRS 2 interpretation of grant date as it gives greater consistency.

The way forward

31. The staff acknowledges that there is uncertainty around the meaning of a shared/mutual understanding of the terms and conditions. However, the staff thinks that attempting to provide detailed guidance on this will lead to a prescriptive rules-based approach.

32. Further, the Board has already indicated that it did not wish to consider the clarification of the definition of grant date and other more significant convergence issues in advance of the liabilities and equity project being completed.

33. The staff notes also that the Amendment does not create any new divergences between SFAS 123 (r) and IFRS 2. Discussions at the IFRS 2 roundtable and with other constituents indicate that the interpretation of grant date under IFRS 2 is being consistently applied and therefore the Amendment is not expected to create any new implementation difficulties.

34. Therefore, the staff does not recommend including any specific guidance on the meaning of ‘shared understanding’ of the terms and conditions.

Does the Board wish to proceed with the Amendment as balloted with no further explanatory guidance in respect of the determination of the grant date?