Section 3 : IFRS 2 “Share-based Payment” review project –April 2010

Report back- Summary and questions on related issues

1. Introduction

The objective of this Paper is to provide a brief summary of the status of the project and the main findings, as well as to raise questions on the principal issues that could be debated at this stage. It is intended to be read in conjunction with the main project report.

2. Reminder of the background and objectives of the project

Following requests for changes to and clarifications of IFRS 2, the IASB decided in 2008 to carry out a review of the standard with a view to clarifying the underlying accounting principles. At the National Standard Setters’ (NSS) meeting in Melbourne (April 2008) the French national standard setter, the ANC, agreed to take on the review project.

The IASB and the ANC agreed at a meeting on 14 January 2009 that the project should seek to clarify rather than change the underlying principles so that IFRS 2 would provide consistent principles-based requirements for representing share-based payment transactions. It was in particular agreed that the following core principles of IFRS 2 would not be challenged within the scope of the review project:

- An asset or a service is recognised by the entity when it receives an asset or a service in exchange for a share-based payment;
- In an equity-settled share-based payment transaction, the reference date for measuring the asset or the expense by reference to the fair value of the equity instruments granted when the entity cannot estimate reliably the fair value of the goods or service received is the grant date for the related equity instruments[1];
- The asset or expense is measured based on a fair value model.

Afterwards, the ANC working group drew up a draft list of accounting principles and their related assumptions. These principles were presented to the EFRAG, the IASB and to the NSS at the NSS meeting in Johannesburg on the 8th and 9th of April 2009 where the above objectives were confirmed. These principles are set out in Appendix 1 of the main Report back paper.

At the NSS meeting in Frankfurt on the 8th and 9th of September 2009 the ANC presented:

- Two alternative accounting objectives that could be considered for IFRS 2 with different possible recognition and measurement approaches, including the effect of different possible interpretations of the notion of service received;
- A first analysis of the interpretation and the related accounting treatment applicable to modifications and cancellations of share-based payment plans for employees.

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[1] This is the case for transactions with employees and others providing similar services (IFRS 2, paragraph 11) or with parties other than employees in the rare cases when the entity rebuts the presumption that the fair value of the goods or services received can be estimated reliably (IFRS 2, paragraph 13).

The ANC met members of the IASB Board and staff on 23 November 2009 to discuss issues raised in the September 2009 Report Paper and possible directions for the project. No final conclusions were achieved on these issues. However, there were no negative reactions to the Report Paper.

The ANC has also invited EFRAG to express opinion on the issues raised in the September 2009 Report Paper to NSS. The Paper and related issues were presented to the EFRAG TEG on 13 November 2009. EFRAG is currently consulting TEG members on these issues.

Although few comments have been received, the ANC working group has continued to work on the project in particular in the following directions:

- Analysing the respective merits of the unit of service method and the modified grant date method in appropriately representing services received, as well as the relative complexity of their application;
- Developing a method that could represent services effectively paid called the "payment approach" in this paper
- Developing a proposal that aims at better representing service received (or paid) in relation to a performance required rather than a presence (work-in-process).

3. Main findings and proposals – Questions on related issues

Accounting objectives

Although the stated objective of IFRS 2 is to represent services received in exchange for share-based payments, the concept of services received is not applied consistently in the standard. In the case of "forfeitures" the "modified grant date method" requires remuneration expense to be adjusted according to the instruments expected to vest. Under this approach, services are only considered to be received if they are "paid for". On cancellation of a plan, "the modified grant date method" requires immediate recognition of outstanding remuneration expense as if the entity had received all of the corresponding services. The required treatment of cancellations would neither appear to represent services received nor "paid for". The ANC working group concluded that the "modified grant date method" does not enable a consistent representation of services received or paid for. Moreover, it is unclear whether the aim of the standard is to represent services received, irrespective of whether they give rise to payment, or only services received that give rise to payment.

ISSUE 1

(a) Do you agree that the modified grant date method as presented in IFRS 2 does not enable a consistent representation of services received or paid in exchange for share-based payments ?

(b) Do you agree that it is unclear what concept of services received IFRS 2 aims to represent (services received irrespective of whether they give rise to payment or only services that give rise to payment), and that this point should be clarified ?

(c) In your view, which of the 2 concepts of services received (paid for or not) seems more appropriate as an accounting objective for representing share-based payment transactions?

Please explain our answers to these three questions.

Recognition and measurement approaches

The ANC is presenting two alternative proposals to amend IFRS 2 depending on the global objective assigned to the standard to portray services received or services effectively paid. These proposals are based on the tentative conclusions of the ANC that the modified grant date method does not allow an appropriate representation of services received and does not appropriately represent services effectively paid in some circumstances. Therefore, the ANC currently considers that:

- The "unit of service method" is the most appropriate method if the objective of IFRS 2 is considered as to represent services received in a share-based payment transaction;
- The "payment approach" is the most appropriate method if the objective of IFRS 2 is considered as to represent services effectively paid in a share-based payment transaction.

The two methods provide different representations of share-based transactions.

The "unit of service method" represents remuneration expense as actual periods of service measured at grant date fair value irrespective of whether those periods of service actually give rise to a payment. Forfeitures, modifications and cancellations arising during the vesting period do not affect previous periods of service as the services for those periods are considered to have been received.

The "payment approach" represents remuneration expense as the fair value of instruments expected to vest. Forfeitures, modifications and cancellations therefore lead to an adjustment of cumulative remuneration expense. Fair value excludes vesting conditions which are taken into account in the number of instruments expected to vest.

The ANC noted that the "unit of service method" has been criticized for its complexity. The ANC concluded from numerical examples (developed in Appendix 4 of the main Report Back paper) that the "unit of service method" is effectively complex to apply, even though not for the same reasons as those noted in the IFRS 2 BCs. However the ANC also noted that the "modified grant date method" also raises application difficulties. Finally, the ANC concluded that the "unit of service method" is the method that more appropriately achieves the objective of representing services received, even if it is complex.

ISSUE 2

(a) Do you agree that the "unit of service method" provides the most relevant representation of services received in a share-based payment transaction? If not, why and what alternative would you propose?

(b) Do you consider that the "unit of service method" should be applied if the objective is to represent services received even it is complex? If not, which alternative approach achieving this objective would you propose? Do you consider that the "prospective modified grant date method" developed in part 5 of Appendix 4 of the main Report back paper could be an alternative in this respect?

(c) Do you agree that the "payment approach" provides the most relevant representation of services effectively paid in a share-based payment transaction? If not, why and what alternative would you propose?

A consistent principles-based approach to accounting for forfeitures, modifications and cancellations

The accounting requirements of IFRS 2 in respect of forfeitures, plan modifications and cancellations are neither consistent nor principles-based. As stated above, the requirements are neither consistent with a "services received" nor a "services paid for" approach.

The accounting treatment in IFRS 2 is subject to the rule that an 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. As a result of this rule, when cancellations or modifications that are disadvantageous to the employees occur, an entity continues to account for services received as if the cancellation or modification had not taken place. On the other hand, if a modification is advantageous for the employee then the fair value of services received is increased as from the date of modification. The accounting for advantageous and disadvantageous modifications in not therefore consistent with one another.

The ANC working group's proposal is therefore to replace this rule-based approach by a principles-based approach based on the agreement between employer and employee including a symmetrical treatment of advantageous and disadvantageous modifications.

The principles-based approach is declined differently according to whether the accounting objective is to represent services received or only services paid for.

The approach is common in that it considers the initial grant date agreement between employer and employee as valid until a modification or a cancellation occurs. From the date of the modification or cancellation the proposal considers that there is a new agreement and that this should be reflected in the accounting.

Under the unit of service approach, forfeitures, modifications and cancellations do not affect service expense recognised prior to those events. In the case of forfeitures, no further expense is recognised after the employees' leaving date. In the case of modification or cancellation, the difference in fair value of instruments granted is determined by comparing their fair value before and after the modification or cancellation at the date of modification or cancellation and the value per unit of service is then adjusted over the outstanding vesting period.

Under the payment approach, remuneration expense is based on the expected number and value of the instruments expected to vest. Where no instruments are expected to vest, because of forfeiture or cancellation, remuneration expense previously recognised is effectively cancelled. Modifications give rise to an adjustment to the number and or value of the instruments expected to vest and remuneration expense is adjusted accordingly as from the modification date. Two alternatives are envisaged: a "cancel and replace" approach and an approach that takes only the fair value difference – measured as in the unit of service approach - into account.

ISSUE 3

Do you agree

(a) That it is necessary to change the rule that remuneration expense should represent as a minimum the initial grant date fair value of instruments granted in order to obtain a principles-based

representation of modifications and cancellations in conformity with the seven accounting principles identified?

(b) With the proposals of the working group in respect of the accounting treatment of forfeitures, modifications and cancellations in the “unit of service” approach? If you consider that modification or cancellation should not result in negative expenses to be recognized, what alternative approach would you propose?

(c) With the proposals of the working group in respect of the accounting treatment of forfeitures, modifications and cancellations in the “payment” approach? Which of the two alternatives proposed would favour and why? If you favour the alternative taking into account only the fair value difference at the date of the modification or cancellation and consider that modification or cancellation should not result in negative payment to be recognized, what alternative approach would you propose?

(d) That the “payment approach” is effectively a “vesting date measurement approach” and as such represents an exception to the reference to the initial grant date fair value? As a result, the adoption of this approach would not be compatible with the terms of reference initially agreed with the IASB?

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1. Reminder of the background and objectives of the project

IFRS 2 “Share-based Payment” was issued in February 2004 for application to annual periods beginning on or after the 1st January 2005. Since that date IFRS 2 has been subject to a considerable number of requests for interpretation and amendment, which illustrate the complexity of the Standard. Some of these requests have lead to interpretations and amendments[2] whilst several requests for interpretation have been rejected by the IFRIC.

Considering the number of requests for changes received, some of which questioning the underlying principles of IFRS 2, the IASB decided in 2008 to carry out a review of IFRS 2 in order to clarify the underlying accounting principles.

At the National Standard Setters’ (NSS) meeting in Melbourne (April 2008) the IASB asked if a NSS would take on the IFRS 2 review project and the French national standard setter, the ANC agreed to do so.

The IASB and the ANC agreed on the objectives and scope of the review at a meeting on 14 January 2009.

It was agreed that the aim of the project was to:

- Clarify rather than change the core principles.
- Ensure the consistency of these principles both within IFRS 2 and in relation to other IFRSs.
- Make the standard easier to understand and to apply.

It was in particular agreed that the following core principles of IFRS 2 would not be challenged within the scope of the review project:

- An asset or an expense is recognised by the entity when it receives an asset or a service in exchange for a share-based payment;
- In an equity-settled share-based payment transaction, the reference date for measuring the asset or the expense by reference to the fair value of the equity instruments granted when the entity cannot estimate reliably the fair value of the goods or service received is the grant date for the related equity instruments when the counterparties of the transaction are employees[3];
- The asset or expense is measured based on a fair value model.

- [2] The interpretation IFRIC 8 clarified the scope of IFRS 2 in January 2006;
- The interpretation IFRIC 11 clarified the accounting treatment of Group and Treasury Share Transactions in November 2006;
- A first amendment to IFRS 2 on Vesting Conditions and Cancellations was issued in January 2008;
- A second amendment to IFRS 2 on Group Cash-settled Share-based Payment Transactions was issued in June 2009; this amendment also incorporated in IFRS 2 the guidance contained in IFRIC 8 and IFRIC 11.

[3]It will be the receipt date when the counterparties of the transaction are others than employees.

Following the meeting in January 2009, the ANC working group drew up a draft list of accounting principles and their related assumptions for presentation to the EFRAG, the IASB and to the NSS on the 8th and 9th of April 2009.These principles are set out in Appendix 1.

At the NSS meeting in Johannesburg on the 8th and 9th of April 2009 the following objectives were confirmed:

- To redraft IFRS 2 to make the standard more principles-based without developing detailed application guidance;
- To maintain the above-mentioned core principles : to recognise an asset or expense as counterpart to a share-based payments, to measure the transaction by reference to the grant date, and to use a fair value (renamed "market-based value" in the ED on Fair Value Measurement issued in May 2009) model;
- To eliminate any inconsistencies within the standard and with other standards when redrafting IFRS 2.

At the NSS meeting in Frankfurt on the 8th and 9th of September 2009 the ANC presented:

- Two alternative accounting objectives that could be considered for IFRS 2 with different possible recognition and measurement approaches, including the effect of different possible interpretations of the notion of service received;
- A first analysis of the interpretation and the related accounting treatment applicable to modifications and cancellations of share-based payment plans for employees.

NSS were invited to comment on the 7 identified accounting principles as well as on alternative objectives and interpretations proposed in the Report Paper, on the basis of 11 questions raised. It was decided that the ANC would make an outline proposal for a revised principles-based version of IFRS 2 at the NSS meeting in April 2010 taking into account comments received. Since then, only one comment letter has been received, which went beyond the limits and constraints defined for the project.

The ANC also met members of the IASB Board and staff on 23 November 2009 to discuss issues raised in the September 2009 Report Paper and possible directions for the project. No final conclusions were achieved at this stage on these issues. However, there were no negative reactions to the content of the Report Paper.

The ANC has also invited EFRAG to express opinion on the issues raised in the September 2009 Report Paper to NSS. The Paper and related issues were presented to the EFRAG TEG on 13 November 2009. EFRAG is currently consulting TEG members on these issues.

Although there were few comments received until now, the ANC working group has continued to work on the project in particular in the following directions:

- Analysing the respective merits of the unit of service method and the modified grant date method in appropriately representing services received, as well as the relative complexity of their application;
- Developing a method that could represent services effectively paid called the "payment approach" in this paper
- Developing a proposal that aims at better representing service received (or paid) in relation to a performance required rather than a presence.

As a result of its analyses and work, the ANC is presenting two alternative proposals to amend IFRS 2 depending on the global objective assigned to the standard to portray services received or services effectively paid. These proposals are based on the tentative conclusions of the ANC that the modified grant date method does not allow an appropriate representation of services received and does not appropriately represent services effectively paid in some circumstances. Therefore, the ANC currently considers that:

- The “unit of service method” is the most appropriate method if the objective of IFRS 2 is considered as to represent services received in a share-based payment transaction;
- The “payment approach” is the most appropriate method if the objective of IFRS 2 is considered as to represent services effectively paid in a share-based payment transaction.

These alternative proposals are also designed in order to be consistent with:

- The 7 accounting principles previously identified (see Appendix 1);
- The core principles of recognising an asset or expenses when an asset or service is received in exchange of a share-based payment transaction and referring to the grant date fair value for measuring the asset or expenses in a equity-settled share-based payment transaction when the fair value of the goods or services cannot be estimated reliably;
- A principles-based approach that should avoid as far as possible rules based provisions, including anti-abuse clauses.

2. Possible approaches to recognition and measurement

2.1 – Two possible principles based approaches identified

The working group considered which recognition and measurement approaches would enable an appropriate representation of share-based payment transactions considering the possible accounting objectives (see Appendix 2) and the definition of services received (see Appendix 3) previously noted:

1. **To represent assets acquired by or services received** by the reporting entity as part of a share-based payment transaction irrespective of whether there is an identifiable payment made by the entity (or by a entity’s shareholder or another entity of the group).
2. **To represent share-based payments** made by the reporting entity (or by an entity’s shareholder or another entity of the group) irrespective of whether there is an identifiable service received by the entity.

It therefore appears that a clarification of the accounting objectives of IFRS 2 is necessary. This question will be raised through a consultation of interested constituents, including the NSS, EFRAG and the IASB.

In order to make IFRS 2 appear more principles based, one should make a clear choice between these two objectives and approaches and develop detailed provisions of the standard consistently. In particular, recognition and measurement principles should reflect the chosen objective and approach. As noted in Appendix 2 and 3, this includes clarification of how the notion of service received is understood.

The ANC tentatively considers that:

- ***The objective to represent services received implies that these services are supposed to be received regularly and to be proportional to the employees' presence (or performance);***
- ***The objective to represent share-based payment effectively vested implies that related services are supposed to be received only if all conditions (presence and performance) are fully completed.***

2.2 - Shortcomings of the modified grant date method to represent either services received or share-based payments effectively made

The current requirements of IFRS 2 are based on the modified grant date method which does not reflect consistently either of the above objectives.

Although IFRS 2 has the stated objective of recognizing goods or services received in a share-based payment transaction (IFRS 2 BC 65 "…the primary accounting objective s to account for the goods or services received…"), the modified grant date method does not enable a consistent representation of services received. For example, in the case of forfeiture, when an employee does not fulfil service or non-market performance conditions, remuneration expense is adjusted to reflect the number of instruments expected to vest. As a result services received that do not give rise to vesting are effectively disregarded. For example, if an employee worked for nearly three years and then left the day before vesting date, under the modified grant date method remuneration expense would be adjusted to cancel services received from this employee, that were previously recognized as a provision.

This accounting treatment may appear as aiming to represent "payment" in the form of instruments expected to vest (see numerical examples developed in Appendix 4) to the extent that no market conditions may prevent the effective payment and no cancellation or disadvantageous modification occur. However, cancellation of share-based payment agreements by the employer does not result in the recognition of services received before the cancellation being cancelled (their recognition is even accelerated), which does not appear consistent with the payment approach. The same kind of statement could be noted where disadvantageous modifications are concerned. Finally, if a market condition included in the initial grant date fair value is not fulfilled, thereby preventing effective payment, this is not reflected in the modified grant date method. This method does not adjust the initial fair value estimate in this respect, which is not consistent with the payment approach.

Moreover, still recognizing at least expenses based on the initial grant date fair value when modifications or cancellations occur may appear inconsistent with a core principle of IFRS 2 that an entity shall recognize services received (or paid) in a share-based payment transaction in consideration of the economic rationale of the exchange (see Accounting principle 1 in appendix 1). The application of this principle also implies that this balanced exchange remains over time in accordance with provisions fixed at the initial grant date (see Accounting principle 6 in appendix 1). Any change in this initial economic rationale of the exchange should be taken into account in order to respect these two principles, which the current provisions of IFRS 2 do not where cancellations

and disadvantageous modifications are concerned. In such a respect, the current provisions of IFRS 2 are not consistent with both services received and payments effectively made.

The measurement principle applied to cash-settled share-based payment transactions appears consistent with the objective of representing payment rather than the value of services received, especially as no distinction between the measurement of services received and fair value changes of the liability due to changes in the fair value of the equity instrument used as an index is required. The working group previously proposed to require such a distinction in a cash-settled share-based payment transaction.

2.3 – Mixed views on which direction to take: both approaches to be explored

The working group did not reach a consensus as to which of the above accounting objectives is the more appropriate. Whilst many of the working group members support the objective of representing services received irrespective of whether there is an identifiable payment, which seems also to be the objective highlighted in the IFRS 2 BCs, it was noted after consulting informally European constituents that a certain number of the latter supported the objective of representing payment irrespective of whether there is an identifiable service. Official consultation with NSS and constituents, as well as discussion with the IASB, did not enable a preferred approach to be identified.

As a result, the working group decided that both of the above-mentioned objectives required further consideration and that appropriate recognition and measurement approaches should be analysed with a view to representing both “services received” and “services paid”.

The working group therefore decided to present proposals for:

(a) The “units of service” method considered as the most appropriate for representing “services received”.

(b) The “payment approach” which is the name given to a proposed approach for representing “services paid”.

3 – General discussion on modifications and cancellations

Modifications and cancellations are similar in substance and should therefore be treated in a consistent manner. Modifications which maintain or increase employee benefits and cancellations replaced by a new plan of equal or increased value for the employee are in substance equivalent. A modification resulting in decreased employee benefits and a cancellation replaced by a new plan with decreased benefits are also similar in substance. A straightforward cancellation without compensation could be considered as a particularly disadvantageous modification.

Therefore, the accounting treatment of modifications and cancellations should be consistent with one another, whatever the circumstances are (advantageous or disadvantageous modifications, cancellations with or without compensations).

3.1 - Discussion on current requirements of IFRS 2 in respect of cancellations

According to the IASB, it would be difficult for an employer to reduce or cancel employee benefits without granting equivalent compensation or implementing a replacement plan (BC 233). Based on this argument IFRS 2 requires, when a plan is cancelled, the immediate recognition of remuneration expense that would otherwise have been recognized over the remainder of the vesting period.

However, and particularly in times of financial and economic crisis as currently experienced it seems difficult to deny the possibility that employee benefits under a plan might be decreased or eliminated without equivalent compensation.

Moreover, it appears difficult to establish a principles-based basis for continuing to recognize expense for services received as if the agreement between employer and employee continued when that agreement has been replaced or cancelled without at least checking if equivalent compensation is granted. This is all the more difficult that recognition of expense for services received was initially justified by the existence of an agreement including a share-based payment.

It would therefore be preferable and a more principles-based approach to analyse if an equivalent (or not equivalent) compensation or replacement has been granted when a cancellation occurs rather than presuming it. Then, an appropriate accounting treatment should be applied to the identified compensation.

3.2 - Discussion on current requirements of IFRS 2 in respect of modifications

The ANC working group considers that the current accounting treatment in IFRS 2 that relates to modifications resulting in increasing the fair value of the considerations given to employees at the date of the modification appears appropriate and consistent with the accounting principles underlying IFRS 2.

IFRS 2 does not however require a symmetrical treatment for modifications that give rise to a decrease in the fair value of the instrument granted. The working group found no principles-based justification for this position. It is stated in BCs that an entity should not be able to avoid recognizing at least the agreed grant date fair value of remuneration.

As for cancellation, this accounting treatment of disadvantageous modification does not seem consistent with the reasoning underlying Accounting Principles n°1 (see Appendix 1) that considers there should be a balanced exchange of consideration that justify the recognition of the expenses. Therefore, changes in the terms of the agreement that determine the balanced exchange should be taken into account where recognition of the expenses is concerned.

4. Objective to represent services received: the Units of service method

4.1 – Background on the Unit of Service method

The Units of Service method was introduced by ED 2 and considered by the IASB as a conceptually sound approach to representing services received. The method was finally abandoned by the IASB

after comments received on ED 2 because it was believed to entail practical application difficulties (see assessment of complexity in part 3.7 below).

In addition, the Unit of Service method described in ED2 includes certain rules for which the working group could find no conceptual justification. These rules, which have been adopted in the current version of IFRS 2 relate in particular to the treatment of modifications and cancellations. They include the requirement for an entity to recognize as a minimum services received measured at the grant date fair value of the equity instruments granted on cancellation and disadvantageous modification as well as the accelerated vesting rule applicable on cancellation.

The working group considered that the requirements for cancellations and disadvantageous modifications in ED 2 were not consistent with the principle of representing "services received".

According to the accelerated vesting rule applicable on cancellation, an entity recognizes immediately all outstanding expense as if all the related services had been received and the employees had completed the vesting period. However, there is no objective reason or material facts to consider that the related services have been provided on an accelerated pace. The employees would also not have particular reason to accelerate the rendering of these services, especially in such circumstances.

Concerning the minimum services received to be measured at the grant date fair value of the equity instruments granted in case of cancellation and disadvantageous modification, this rule does not seem consistent with the rationale underlying Accounting principle 1 (see Appendix 1) that justify the recognition of services received as balanced counterpart of share-based payments promised at the grant date.

However, on forfeiture where the employee leaves before completing the vesting period, ED2 requires recognition of an expense up until the resignation date.

The working group noted that the treatment of forfeitures and cancellations proposed by ED2 was not consistent with one another. It was therefore decided to adapt the Unit of Service method to enable a consistent principles based representation for forfeitures, modifications and cancellations.

4.2 – General description of the Unit of Service method

The objective of this method is to represent services received from employees in exchange for share-based payments.

The method is based on the assumption that there is a balanced agreement at the grant date such that the fair value of services expected to be received is equivalent to the fair value at that date of equity instruments expected to be issued.

Proposal

Services received are recognized proportionally according to the duration of service during the vesting period.

A fair value per unit of service is determined by dividing the grant date fair value of the equity instruments to be issued, allowing for all vesting conditions and including the expected rate of forfeiture, by the number of units of service expected to be received.

The actual number of units of service received is measured at the fair value per unit of service.

4.3 – Treatment of forfeitures using the Unit of Service Method

Proposal

When an employee leaves without completing the vesting period the services received from the employee prior to leaving are recognized up until the departure date. No further remuneration expense of services received is recognized once the employee has left.

Rationale and comments

The number of units of service actually received by the employing entity until the employee leaves is measured at the grant date fair value per unit of service calculated as indicated above. As a result the employing entity recognizes remuneration expense for the period during which the employee is present even though no share-based payment will be made for that period because the vesting condition has not been fulfilled.

The rationale for this treatment is that the entity is considered to have received service during the period the employee was present even though he did not complete the vesting period and would not therefore be entitled to a share-based payment.

This approach contrasts with the current requirements of IFRS 2 under which the remuneration expense in case of forfeiture is revised to reflect the number of instruments expected to vest. Under current requirements, where an employee leaves before vesting date, the service expense recognized prior to the employee leaving is cancelled. The current requirements of IFRS 2 with respect to forfeitures could therefore be said to reflect an approach based on "services paid" rather than "services received".

4.5 – A principles-based approach to modifications and cancellations using a Unit of Service method

Proposal

An entity recognizes services received up until the occurrence of a modification or a cancellation on the basis of the initial agreement between employer and employee, i.e. the entity recognizes the actual number of units of service received up until the date of modification or cancellation measured at the initial grant date fair value per unit of service. No adjustment to this expense recognized before the modification or cancellation is made.

Changes in the fair value of the share-based payment resulting from a modification or cancellation reflects a change in the fair value of services expected to be received as from the date the new balanced agreement takes place. This change is taken into account in recalculating the unit value of services expected to be received as from this date. Changes to the initial agreement are applied prospectively over the outstanding vesting period, if any, otherwise immediately.

The fair value change taken into account in recalculating the unit value of services expected to be received is measured by comparison - at the new grant date related to this agreement - between the fair value of instruments granted according to the new agreement and the fair value of instruments granted according to the initial agreement.

Rationale

The working group considered that a consistent principles-based approach to representing services received should be based on the agreement between employer and employee. The initial balanced agreement between employer and employee takes place at the grant date, as stated by Accounting Principle n°6 (see appendix 1). However, this agreement may be modified subsequently and the modification might be either advantageous or disadvantageous for the employee or result in a cancellation with or without compensation. The accounting should therefore reflect the changes in the agreement as and when they occur on a prospective basis to recognize services received in accordance with the new balanced agreement achieved at the new grant date. Moreover, the accounting treatment should be symmetrical for advantageous and disadvantageous modifications, as the accounting consequences of the new balanced agreement should be recognized the same way whatever the difference with the old one is.

It is therefore proposed that an entity should recognize services received up until the occurrence of a modification or a cancellation on the basis of the initial agreement between employer and employee. The entity would therefore recognize the actual number of units of service received up until the date of modification or cancellation measured at grant date fair value per unit of service. According to the services received approach, subsequent modifications or cancellation would not affect services already received as part of the initial agreement between employer and employee and there should therefore be no adjustment to the remuneration expense initially recognized.

This absence of re-measurement of previously recognized services received is also further justified in case of equity-settled share-based payment transactions, where the equity interests granted which are the measurement basis for services received should not be re-valued afterwards (Accounting principle n°7 in appendix 1).

It follows that changes to the initial agreement will be applied prospectively over the outstanding vesting period. According to accounting principle 5 set out in appendix 1, “The asset or service received is measured at the fair value of what is received or of what is given up according to the general principles applicable to exchange transactions”. If an entity modifies the value of the share-based payment it implies that this modification reflects a change in the value of services expected to be received as from the date the new balanced agreement takes place.

The working group considered that the fair value of instruments granted should be reassessed at the date when a change to the initial agreement occurs. Where, for example, the employer changes the exercise price of an option, the effect on the fair value of the instruments granted in comparison to the fair value at the date of the modification of the instruments initially granted is considered to reflect a change in the value of services received in exchange as from the date of change. The effect of this difference in value would be taken into account in recalculating the unit value of services expected to be received. An illustration of how this difference is taken into account is set out in Appendix 5. Taking into account only the fair value change of the instruments at the date of the modification is consistent with current approach applied in IFRS 2 to advantageous modification and with Accounting principles 6 (use of the initial grant date as reference for fair value measurement in some circumstances as long as the initial agreement is maintained, use of the new grant date as a reference for fair value measurement as from its occurrence) and 7 (no further re-measurement of equity interest already acquired in an equity-settled share-based payments) as described in Appendix 1. The working group considers that this approach should apply to both advantageous and disadvantageous modifications in order to achieve a principles-based approach.

Comments

In those cases where the modification or cancellation is beneficial to the employee this will result in an increase of remuneration expense to be recognized over the outstanding vesting period. As illustrated in Appendix 5, the remuneration expense to be recognized over the outstanding vesting period will comprise a portion as calculated under the initial grant plus an increase due to the beneficial modification or cancellation. It may be noted that in some cases, a consequence of this prospective imputation of value changes on services received may result in a sharp rise of the fair value of these services compared to those recognized before the change. One may question such a difference in the valuation of services which substance remains globally the same. This is an effect of the Accounting principles obliging to refer to the grant date fair value in circumstances indicated in part 1 of the Paper and prohibiting further re-measurement of equity-settled share-based payments.

The working group considered that it might also be possible that under certain exceptional circumstances, such as in times of economic and financial crisis, employees might be forced to accepting changes which might be disadvantageous. In a principles-based approach, the treatment of disadvantageous modifications or cancellations should be symmetrical to that of beneficial changes.

Disadvantageous modifications and cancellations would result in negative adjustments to remuneration expense as illustrated in Appendix 5. It might be possible for total remuneration expense for a period to be negative (i.e. a credit) subsequent to a modification which is disadvantageous for employees.

It is considered that such cases would be rare as normally employees would refuse cancellation or disadvantageous modifications when granted share-based payments have a high fair value at the time of the renegotiation (case A in appendix 5). This may rather occur when the fair value of the granted instrument is so low that reducing or cancelling them will not make a significant difference (case B in appendix 5). In such cases, remuneration expense would be reduced but would generally still have a positive value, as the reduction of an already low current fair value would normally be slight.

Nevertheless, were such a situation to arise, the appropriateness of the accounting treatment may be questioned. One may consider that negative remuneration is not plausible. This could imply that the method for representing remuneration may be inappropriate at least in this case. It was observed that even where the employee accepts a significant drop in remuneration as compared to the fair value of the instrument at the date of modification, the instrument still has a positive value and the disadvantageous modification should therefore not give rise to negative remuneration expense. However, the approach that charges the fair value change prospectively from the date of the change to services still to be received, while consistent principles underlying the "services received" approach, cannot prevent in all cases situations where the negative value of service received may be perceived as apparent representational anomalies. These kinds of situations also result from the use of the grant date fair value as a reference in circumstances described in part 1 of the Paper and the prohibition to re-measure equity-settled share-based payments afterwards.

The working group considered if it might be necessary to adopt a "rule" to cover those circumstances e.g. remuneration can never be less than zero and a flooring adjustment is therefore necessary to correct negative remuneration. However, the objective of this project is to establish principles-based accounting treatment for share-based payment transactions in all circumstances within the scope of IFRS 2 while not questioning the reference to the grant date fair value in some circumstances. If we want to achieve this objective while respecting these conditions, we should accept the perspective of having situations in which application of the principles-based approach together with reference to the grant date fair value result in negative expenses to be recognized.

It may be noted that the current provisions of IFRS 2 obliging to recognize as a minimum the initial grant date fair value in case of cancellation or disadvantageous modification also represent a "floor rule". As noted before, it is also inconsistent with the principles-based approach that the project aims at developing. It is even more inconsistent compared to the "zero floor rule" than it may apply in more circumstances.

The working group considered whether "negative remuneration" might, in those rare circumstances where it occurs, have some economic basis. It might, for example, be possible to assimilate all or a part of modifications or cancellations to a repurchase or exchange of the instruments initially granted (or equity interests acquired thereof) followed by a new grant of instruments of a different value. Where the agreement between employer and employee is renegotiated to the employee's disadvantage in exceptional circumstances under which the employee "makes a sacrifice", there would not necessarily be any direct relationship between the terms of the renegotiation and the value of the employee's services. The "profit" of the entity on renegotiation is of an exceptional nature and might be compared to the action of a creditor (the employee) that is prepared to write off a part of the debt of its debtor (the entity) as part of an ongoing relationship. In such a perspective, all or a part of the fair value change measured at the modification or cancellation date would rather be charged on repurchase or exchange of previously granted equity interests at a advantageous price for the entity. However, there are still pending questions on how to justify and determine this part and to recognize the related "profit" (in the income statement, as a financial profit, or directly in equity as a transaction with owner of equity elements of the entity). Moreover, this interpretation approach of disadvantageous modifications and cancellations should also be applied to advantageous ones in order to be principles-based.

Another aspect which might be considered is that share-based payments are often only one component of a remuneration package such that a reduction in one component may be compensated by an increase in another component. However, this should not be presumed. The transfer between the different elements of the remuneration package should de identified, which may not be easy.

4.6 - Treatment of compensation payments in respect of cancellation

Proposal

If the compensation is subject to a vesting condition, it is recognized over the vesting period. In this case the compensation remunerates expected services to be received after the cancellation date. It is the basis for determining a new fair value per Unit of service. However, where no such vesting condition exists the compensation does not remunerate expected future services and therefore should be recognized immediately.

Any difference arising between the amount of the compensation and the fair value of the instruments granted at cancellation date is treated as an adjustment (increment or decrement) to remuneration expense, as in the general cases of modification/cancellation described above.

Rationale

Where an employer cancels a share-based payment plan employees may receive total or partial compensation for the loss of benefits.

The working group considered that compensation payments were in substance similar to a new agreement between employer and employee and should therefore be treated in the same way as a

cancellation replaced by a new agreement. Finally, such a situation could be considered as a modification of the initial plan.

The compensation might be granted subject to a vesting condition, in which case it should be recognized over the vesting period. In this case the compensation remunerates expected services to be received after the cancellation date. It would be the basis for determining a new fair value per Unit of service.

However, where no such vesting condition exists the compensation does not appear to remunerate expected future services and therefore recognition should be immediate.

The working group considered the payment of compensation to be the same in substance as a modification to the original agreement between employer and employee. Any difference arising between the amount of the compensation and the fair value of the instruments granted at cancellation date is treated as an adjustment (increment or decrement) to remuneration expense under the original agreement in the period of cancellation. This approach is illustrated in Appendix 5. When there is a positive adjustment for the entity's benefit resulting in a negative remuneration charge in the period, this may appear counter-intuitive. The same discussion on negative value of services received may occur as in the general case of modification and cancellation.

Comments

An alternative approach would be to consider the payment of compensation as a repurchase of the instruments originally granted at their value at the date of cancellation. Any difference arising between the amount of the compensation and the fair value of the instruments granted at cancellation date is treated as a profit or loss on repurchase which , in the case of a profit, is less counter-intuitive than considering the adjustment as negative remuneration.

IFRS 2 §28 considers the payment of compensation as a repurchase of equity instruments that vest immediately on cancellation. According to this analysis, the payment made to the employee should be deducted from equity (which is not the accounting treatment currently applied in IFRS 2). There is not clear evidence that a cancellation should be interpreted as an accelerated vesting of the instruments granted and their immediate repurchase, as discussed in part 3.4. Compensation may however be interpreted as a repayment for accumulated partial rights to the instruments granted.

4.7 – Assessment of the Unit of Service proposal

Faithful representation of service received

This Unit of Service method arguably provides a faithful representation of services effectively received by an entity, assuming that these services are received gradually. It seems compatible with the main accounting objective to represent services received and with the definition of services received on an accrual basis proportionally to the presence of the employee during the vesting period.

Complexity

This method was not finally adopted by the Board for practical reasons (complex to apply) rather than reasons of principle. These reasons include the difficulties of estimating the grant date fair value of certain non-market performance conditions and the need to track individual employees where all employees do not have identical rights under a scheme. Tests on numerical examples

confirm that the Unit of Service method may be complex, as it requires tracking each employee individually.

However, the modified grant date also includes some complexity as it requires periodic revisions of probability related to vesting conditions. And the need to track groups of employees that do not have the same rights seems to be common characteristics of both methods. Finally, it may be envisaged that some non-market performance conditions could be treated as vesting conditions under a Unit of Service approach. The working group is working specifically on this issue (see below).

Representation of service received related to performance required

Another question is the appropriate representation of performance, which may necessitate revision of the notion of services received. For example, where an employee is present at the vesting date but a performance condition has not been met, has the entity received the required services? The IASB took the position in ED 2 that services had been received and that the corresponding expenditure should be recognized, although this position was not shared by many commentators. The current provisions of IFRS 2 therefore do not allow performance conditions to be considered as vesting conditions independently from presence conditions.

A variant of the Unit of Service method separating realisation of performance conditions which have to be performed directly by the employee from the grant date fair value might also be considered. This implies that these performance conditions are under the control of the employee and their achievement is representative of the achievement of the service expected from the employee. The distinction between these performance conditions and other conditions may be difficult to assess.

Another question would be how to assess if and to which extent these performance conditions are met. By analogy with the definition of service as received on an accrual and proportional basis, the performance conditions could be considered as partially met using a proportional measurement method. However, it may be difficult to determine which kind of measurement process could be applied. The ANC working group is analysing in a separate paper if and how some performance conditions could be separated from the initial fair value measurement at grant date and used as vesting conditions.

Treatment of negative expenses

Finally, there is still a question on how to treat fair value differences arising from modifications or cancellations especially if they result in negative amounts that would make the services received after the change having a negative value. In a principles-based approach, one should accept the result as it is, even if it seems counter-intuitive to have negative expenses in some (normally rare) circumstances; this would be seen as the potential result of a principles-based approach developed together with reference to the grant date fair value in specific cases. However, the working group may explore other avenues:

- the first one would consist in imposing a “floor” at zero to the fair value of services received, which would avoid the “abnormal” situation of negative expense; however, this provision would be rules-based and therefore would not allow to achieve a principles-based approach;
- the second one would be to keep the current provisions of IFRS 2 imposing a “floor” at the initial grant date fair value; however this provision would be as rules-based as the previous

one and would apply to more situations (even when subsequent amounts remain positive but lower than the initial grant date fair value);

- the third one would consist in considering that not all of the change should be charged as services expense; one part would be considered as resulting from repurchase/replacement of equity interest already potentially acquired by employees in the course of the initial share-based payment agreement; this part could be recognized apart from service expense (either as financial profit and loss or as equity directly); there are still questions on how to justify the alternative qualification of part of the fair value change and on how to distinguish this part.

It may be noted that most of the difficulties in developing a principles-based approach come from the reference to the grant date fair value used in theoretically specific circumstances - but concerning in fact the most usual cases of share-based payment transactions between employers and employees.

5. Objective to represent services paid: the payment approach

5.1 – General description of the Payment Approach

The objective of this method is to represent "services paid" in the form of instruments that effectively vest. Under this approach services are only deemed to be received to the extent that a payment is made.

This approach is based on the existence of an agreement between employer and employee. The initial agreement is based on the terms of exchange fixed at grant date but may subsequently be modified or cancelled.

Proposal

The fair value and the number of instruments expected to vest is determined at grant date.

The fair value does not include any elements that may prevent the instruments to be effectively paid. All these elements are included in the estimate of the number of instruments expected to vest. They all are considered as vesting conditions. Therefore, these vesting conditions include not only presence or non-market performance conditions, but also market conditions and other types of conditions, if any, that may prevent effective payment of the instruments granted.

Fair value corresponds to initial grant date fair value until a modification or a cancellation occurs.

"Services paid" are measured at the grant date fair value of instruments expected to vest.

Expense is recognized on an accrual basis over the vesting period on the basis of the number of instruments expected to vest in order to represent services expected to be paid. The number of instruments expected to vest is reviewed and adjusted as necessary at each reporting date depending on changes in estimates related to the different payment conditions. Ultimately expense is adjusted according to the actual number of instruments that vest.

As a consequence, where an entity has provided for expenditure for which the payment conditions are not ultimately satisfied, the expenditure will be reversed accordingly.

The fair value and/or the number of instruments expected to vest is revised on modification or cancellation.

5.2 – Forfeitures

Proposal

When an employee leaves without completing the vesting period the number of instruments expected to vest is adjusted and the accrued remuneration expense relating to that employee is cancelled.

Rationale

The rationale for this treatment is that the entity has not received the required service because the employee has not satisfied the vesting condition. This is consistent with a definition "all or nothing" of services expected to be received, the main substance of the service consisting in fulfilling the vesting conditions. This approach is similar to the current requirements of IFRS under which the remuneration expense in case of forfeiture is revised to reflect the number of instruments expected to vest.

5.3 – Modifications and cancellations

The treatment of modifications and cancellations is illustrated in Appendix 6.

Proposal

Changes in the initial agreement in the form of modifications or cancellations give rise to a new grant date fair value and/or a new assessment of the number of instruments to vest as from the date of change;

This new grant date fair value and/or new number of instruments to vest replace(s) those previously recognised.

Rationale

In a "payment approach" service expense is only recognized to the extent that instruments vest. It is a "all or nothing" approach in terms of services received considering that the main substance of the expected service is that the counterparts fully complete the vesting conditions. The new fair value of instruments granted at the date of the cancellation or modification therefore applies to the whole service expected in exchange, including the part already rendered that cannot be considered as separated. Therefore service expense is corrected globally at each modification or cancellation date to represent over the new vesting period – including the part of the previous one already passed if the change can be considered as a modification of an existing plan - the cumulative fair value of instruments expected to vest and is ultimately adjusted to represent the fair value of the instruments that actually vest.

Comments

This "cancel and replace" approach has been questioned because many members of the group thought that the proposed approach does not respect in practice the Accounting principle n°7 in Appendix 1 that prevent to re-measure equity-settled share-based payments transactions (more specifically equity interest already potentially acquired by employees in the course of the share-based payment plan) which fair value has been determined at the grant date (Accounting principle n°6 in Appendix 1).

Therefore, the working group considered an alternative approach by which the amount of the payment is re-measured on modification or cancellation taking into account the original grant date fair value and an incremental/decremental fair value adjustment at the date of modification or cancellation. The increment or decrement is based on the fair value of the instrument at the date of modification or cancellation. The fair value change is therefore measured the same way as it is described for the Unit of Service method in paragraph 3.5. As a result, this approach gives the same results for modification or cancellation as for the Unit of Service method illustrated in Appendix 5. this alternative approach would be consistent with Accounting Principles n°7 noted above. However, it would result in equity instruments vested being recognized partly at the initial grant date fair value, partly at the modification/cancellation grant date fair value. Moreover, this approach may result in negative value of vested instruments to be recognized in some cases, which may appear counter-intuitive (as for service received in the Unit of Service method).

Many members of the working group question the consistency between a "payment" approach and the reference to the grant date fair value. They think that the objective of representing services paid would rather be achieved by using the vesting date as fair value reference date.

Compensation payments in respect of cancellation

This compensation should be treated in the "cancel and replace" approach - described above for modifications as the first possible approach – as immediate payment or payment subject to a new vesting period (including the part of the previous one already passed if the change can be considered as a modification of an existing plan).

It would be treated similarly to the incremented / decremented fair value (at the date of the change) approach as for the Units of Service approach, if the alternative approach described above is applied.

5.4 – Assessment of the Payment Approach

The method is based on "vesting" which is an observable triggering event. It appears less subjective than an approach based on "services received" which may be difficult to identify and measure. However, it seems that there is a inconsistency between this approach representing instruments vested (or services received in exchange of instruments effectively vested) and the reference at the grant date fair value. In fact, the base approach that consist in cancelling and replacing instruments granted at the date of a modification/cancellation is not consistent either with reference to the initial grant date fair value nor with no re-measurement rule of already potentially acquired equity interests. The alternative approach would better respect the reference to grant date fair value. However, it would result in a heterogeneous measurement of instruments vested in case of modification/cancellation, as these instruments would be partly measured at the initial first grant

date fair value amount and partly at the modification grant date fair value. Some believe that reference to the vesting date fair value would be more appropriate in this approach.

In term of complexity, this method appears much simpler to apply than the Unit of Service one.

However, as service expense is adjusted globally to reflect the instruments expected to vest, this method may give rise to large fluctuations in the result of any given period. This may question the relevance of what this approach may portray in interim reporting periods included in the global vesting period.

The application of this method gives different results to the Unit of Service method (see Appendix 5 and Appendix 6). The Payment method requires the adjustment of cumulated service expense to reflect the amount expected to vest. Under the Units of Service method service expense incurred is not corrected retrospectively on the grounds that the services were effectively received.

The Payment approach is close to the modified grant date method subject to:

- The grant date fair value not including market (or other currently non-vesting) conditions
- The difference in treatment of modifications and cancellations

To the extent that the payment approach is closer to the existing requirements of IFRS 2 (modified grant date method) it could be presented as an improvement to the existing approach rather than a replacement of the existing approach.

APPENDIX 1 : ANALYSIS OF THE KEY ACCOUNTING PRINCIPLES

(extract from the Report Back Paper presented at the Frankfurt NSS meeting in September 2009)

Accounting principle 1

An entity shall recognize goods or services received in exchange for share-based payments[4] as an asset or expenditure respectively[5].

General case

When goods or services are acquired from a third party they can generally be easily identified as a contract is generally required where considerations exchanged are precisely defined. The contract will also usually enables the determination of the fair value of the considerations exchanged, as well as exchange conditions and timing.

Specific case

However, some services cannot be clearly identified. This is the case in particular of services received from employees in exchange for share-based payments. They are by nature difficult to identify and measure directly independently from the usual work to be provided by employees in exchange for their basic cash salaries.

It is assumed that when an entity makes a share-based payment it receives corresponding consideration irrespective of whether that consideration can be clearly identified. This assumption applies to services received from employees in exchange for share-based payments.

Rationale

As stated in IFRS 2 BC 37, the entity's directors would be in breach of their fiduciary duties to the shareholders if employees provided nothing in return for a share-based payment. It would be rational to consider as a general economic principle that where consideration is given an equivalent amount of consideration will be received in exchange. If an employer offers a share-based payment to his employees (with the agreement or preliminary authorization of the shareholders) in addition to the rest of their remuneration package, this may mean that this additional remuneration is necessary to obtain the employees' agreement to provide an additional service[6]. The fact that this additional service (or this part of the usual work – see footnote 3) cannot be clearly identified or differentiated does not necessarily mean that the service does not exist.

Accounting principle 2

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[4] These share-based payments are not made with a shareholder acting in his capacity as a shareholder.

[5] This analysis will not challenge the statement that share-based payments should be considered as an expense of the issuing entity. This basic assumption, which has been extensively discussed when IFRS 2 was initially elaborated, forms part of the frame of reference of the project.

[6] Sometimes, especially in start-up entities, the share-based payment is part of the normal remuneration package of the employees and will pay a part of their usual work.

An asset or an expense shall be recognized even if the share-based payment is made by a shareholder of the entity or another group entity.

<u>General case</u>

When a shareholder of the entity or another entity of the same group makes a share-based payment to a supplier or to employees of the entity, it is assumed to be in consideration for an asset or service received by the entity.

In this case, the entity receiving the goods or services without the obligation to settle the share-based payment transaction to the supplier or its employees recognizes an equity-settled share-based payment transaction. The shareholder or entity of the same group which settles the share-based payment transaction recognizes it as an equity-settled share-based payment transaction if it is settled in their own equity instruments. Otherwise, they recognise it as a cash-settled share-based payment transaction.

<u>Rationale</u>

The ANC working group has not identified reasons to question this accounting treatment which has been clarified by the June 2009 amendment to IFRS 2. There are merits in applying consistent accounting treatment in the separate financial statements of the entity receiving the goods or services as well as of the entity settling the share-based payment, and in the consolidated financial statements of the group.

Accounting principle 3

The asset is recognized when received and an expense is recognized when the asset received is consumed or the service received.

<u>General case</u>

For assets or services that can be readily identified, it is generally easy to identify the date when the asset is received or the period over which the service is received. This date or period will be considered as the date or period of recognition.

<u>Specific case</u>

When, as for most services received from employees, the asset or service cannot be readily identified the recognition date or period need to be determined indirectly by reference to the terms of the contract:

- Where entitlement to the share-based payment is linked to the completion of a vesting period, the service is assumed to be carried out evenly over that period unless otherwise indicated
- Where entitlement to the share-based payment is not linked to the completion of a vesting period, the service is assumed to be carried out immediately

<u>Rationale</u>

When a service cannot be readily identified, and therefore the date when, or period over which, it is received cannot be directly determined, the most objective way to approximate this date or period is

to refer to the terms of the contract. Therefore, if the terms of the contract include a vesting period, it may be assumed that the services are required to be provided during this period.

In IFRS 2 BC 201, it is noted that some argued that services may have been provided before the vesting period, whereas other argued that services may continue to be provided after the vesting period.

If share-based payments are provided for past services, they should logically be granted immediately, i.e. without a vesting period. The accounting treatment of such share-based payment is immediate recognition of the expense. This seems to be the adequate accounting treatment as the related services were provided before the grant date and if the payment is immediate and unconditional. When a vesting period is required for the granting of all or part of the share-based payment, it may be assumed that the related services have not yet been provided. Otherwise, granting share-based payment without a vesting period in exchange for a service that has not yet been provided would put the entity into a situation where it bears the expense whatever subsequently happens. Therefore, it would be appropriate to recognise the expense immediately in this case. As concluded in IFRS 2 BC 202, it may appear reasonable to consider that presuming the services are received during the vesting period, if any, is a good approximation when these services cannot be readily identified or distinguished.

After completion of the vesting period, employees owning equity instruments of the entity may have an interest in acting in order to enhance the fair value of the entity's equity instruments. They also may develop some strategy related to their expectations of subsequent fair value changes of their equity instruments, depending on the exercise conditions. This may result in these employees providing additional services to the entity in some cases. However, the existence and value of these services would depend on circumstances that no longer have a close relationship with the initial agreement achieved at the grant date.

Accounting principle 4

Consideration given for the goods or services received is recognized in equity or in debt according to the type of payment.

<u>*General case*</u>

The ANC working group noted that the current definition of equity and debt in IFRS 2 is very concise and makes reference to the Framework only. This creates differences with the definition of equity and debt in IAS 32 on the grounds that it is a service being measured and not a financial instrument, as well as that in certain cases the number of share options to which the employees are entitled varies (IFRS 2 BC 107).

Some differences in practice can be noted, such as:

- A settlement of a variable number of shares (issue of a variable number of shares in exchange for a fixed amount) can be considered as an equity-settled share-based payment;
- Constructive obligation to pay in cash resulting in the share-based payment being considered as cash settled;
- Contingent settlement not dealt with;
- Split accounting being slightly different from IAS 32.

The classification will depend on the nature of the instrument the entity ultimately remits to the beneficiary.

The ANC working group considers that the distinction between equity and debt should be consistent with the requirements of IAS 32 although this is not the case in the current version of IFRS 2.

Rationale

As mentioned above, IFRS 2 BC 107 highlighted that in some cases the number of share options to which employees are entitled may vary depending, for example, on whether, and to the extent that, a particular performance target is exceeded. Applying the definition of equity in IAS 32, which requires the number of equity instruments to be issued on settlement to be fixed, would in such cases result in considering the share-based payment as cash-settled and therefore in re-measuring it after the grant date. The Board considered that such a re-measurement should be avoided and therefore that the definition of equity in IAS 32 should not be applied to IFRS 2.

The ANC working group acknowledges that some contracts include provisions that may make the number of equity instruments granted to employees vary depending on a particular performance target being exceeded. However, it may be noted that this does not mean that, for a given performance achieved, the number of equity instruments granted is variable. It may be considered that, in such cases, there are a fixed number of equity instruments granted for each element of service or performance performed. For example, if 10 equity instruments are granted if a certain level of performance is achieved and 5 more if a higher level of performance is achieved, one may consider that the number of equity instruments granted is fixed for each required level of performance: 10 for the first one, 5 more for the second one (achieving the second one means that the first one has already been achieved and the 10 first equity instruments have already vested). The ANC working group has not yet identified a contract where the number of equity instruments granted may vary for a given service or level of performance.

Therefore, it could be considered that there is no inconsistency between the definition of equity in IAS 32, including the requirement that the number of equity instruments to be issued on settlement should be fixed, to be applied in IFRS 2 and the accounting principle that equity instruments granted should not be re-measured subsequently. Applying the definition of IAS 32 would therefore create no undesirable consequence in this respect, while achieving a consistent approach between IFRS 2 and IAS 32.

It may also be noted that it would be easier to implement the expected new definition of equity and debt in the future when the current provisions of IFRS are consistent on this point in all the standards.

Concerning the fact that IFRS 2 focuses on the measurement of the service instead of the financial instrument, it may be noted that recognition of the counterpart of the services (or goods) as equity or debt is a question of classification, not measurement, and can be solved independently from the recognition of the service.

Accounting principle 5

The asset or service received is measured at the fair value of what is received or of what is given up according to the general principles applicable to exchange transactions.

General case

For cash-settled share-based payment transactions, the entity shall measure the goods or services received at the fair value of the liability incurred.

For equity-settled share-based payment transactions, the entity shall measure the goods or services received directly at the fair value of the goods or services received (unless that fair value cannot be estimated reliably).

Specific case

If the fair value of the goods or services received cannot be estimated reliably, the entity shall measure their value indirectly by reference to the fair value of the equity instruments granted.

The ANC working group has not seen significant reasons to question this accounting treatment.

Rationale

The ANC working group has analysed if the general principles relating to exchange transactions were applied in IFRS 2 (in particular in BC 61 to 68) consistently with the way they have been applied in other IFRSs. Therefore, the relevant requirements of IAS 16 *Property, Plant and Equipment* which are amongst the most detailed in IFRSs setting out the general principles applicable to exchange transactions have been closely examined.

IAS 16 paragraph 23 requires that, when an asset or service is received in exchange for a fixed amount of cash at the recognition date, the fixed amount of cash is assumed to represent the cost of the consideration received. This is consistent with the statement in IFRS 2 considering that, for cash-settled share-based payment transactions, the goods or services received and the liability incurred are measured at the fair value of the liability, which – at the receipt date – represents the cost of the consideration received.

For payments of a non-monetary nature, IAS 16 paragraph 26 states that the fair value of the asset given up is used to measure the asset or service received unless the fair value of the latter is more reliable. This is consistent with the statement in IFRS 2 considering that, in general cases where an equity-settled share-based payment is made, the entity shall measure the goods or services received directly at the fair value of the goods or services received (unless that fair value cannot be estimated reliably), as the measurement of this fair value is assumed to be more reliable than the measurement of the fair value of the equity instruments given up. Moreover, some may argue that the equity instruments given up are not assets by nature, but only a difference between the total assets and total liabilities of an entity.

However, in the specific case of an equity-settled share-based payment made in exchange for services received from employees, the fair value of the equity instruments given up may appear more reliable than that of services received since the latter are difficult or impossible to identify and measure directly. Therefore the fair value of the equity instruments given up is used to measure the transaction. This is consistent with paragraph 26 of IAS 16 that requires using the fair value of the asset given up when the fair value of the asset received is not more reliable.

As a conclusion, it seems that the application of the general principles applicable to exchange transactions in IAS 16 and IFRS 2 are consistent with one another.

Accounting principle 6

Initial measurement is made (at the fair value) at the exchange date.

General case

When the asset or service received is readily identifiable, the date or period of exchange can generally be easily identified in conformity with Accounting principle 3, and measurement takes place at that date in conformity with Accounting principle 5.

Specific case

When the asset or service received is not readily identifiable, such as in the case of services received from employees, the date or period of exchange is determined by reference to the contract and in particular by reference to the vesting period where applicable, as explained in specific cases dealt with in applying Accounting principle 3.

As stated in Accounting principle 5 above, equity-settled share-based payments for employee services are measured at the fair value of the equity instruments given up.

This fair value is determined at "grant date"[7].

Rationale

The fair value at "grant date" is considered as the reference for measuring the transaction at the exchange date on the grounds that it is the date at which the two parties agree on the terms of the exchange. As explained in IFRS 2 BC 96, the fair value at "grant date" represents the balanced value on which the parties agreed to exchange considerations.

It may be argued that the "grant date" is not the date (or period) when the considerations are effectively exchanged. The "service date" or vesting period could be considered as more representative of when the exchange effectively takes place. However, there may be concerns about whether the subsequent changes in fair value of the share-based payment granted are representative of the value on which parties to the contract agreed to exchange considerations. As noted by the Board in IFRS 2 BC 95 and 104, it is unlikely that subsequent changes in the fair value of the instrument to be issued could be considered as highly correlated with changes in the fair value of services received. It is for this reason that measurement at "service date" i.e. re-measurement during the vesting period is not considered appropriate.

It may be also noted that once the terms of the contract are fixed at "grant date", they are not changed afterwards whatever changes in the fair value of the instruments granted are, which may be understood as the parties still agreeing on the initial terms of the contract, unless the contract is subsequently modified or cancelled. Effects of modifications or cancellations will be analysed further specifically. Therefore, in the absence of modification or cancellation of the contract, the fair value at "grant date" may be considered as a good surrogate measure of the fair value of the services received.

It is at "vesting date" that the employee becomes entitled to receive the equity instruments. It may therefore seem appropriate to measure the transaction at that date. However, services are received from the employee over a period of time and not specifically - and certainly not entirely only - at the vesting date. Therefore, mirroring equity interests are also granted over a period of time, as

[7] This analysis will not challenge the statement that "grant date" is an appropriate surrogate measure of the fair value of the services rendered. This basic assumption, which has been extensively discussed when IFRS 2 was initially elaborated, forms part of the frame of reference of the project. Arguments are only provided as a reminder.

noted by the Board in IFRS 2 BC 101. Measuring these equity interests at "vesting date" would be contrary to the principle of not revaluing equity instruments (IFRS 2 BC 103).

An employee finally exercises his rights to remuneration at "exercise date". However, the "exercise date" occurs after the exchange date or period which is complete on vesting. Moreover, "exercise date" measurement would also require re-measurement of the equity instruments.

Accounting principle 7

Subsequent measurement of share-based payment transactions reflects the nature of the related reference items (debt or equity) according to the general principles of accounting for exchange transactions.

General case

For cash-settled transactions, where the reference item is a liability, the latter is re-measured at each reporting date to reflect changes in the fair value of the related equity instruments according to the terms of the contract.

For equity-settled transactions the fair value of the instrument used to measure the transaction is not re-measured subsequent to the grant date.

Rationale

The general accounting principles in the IFRS framework is that a liability is re-measured to reflect the current related obligation to pay cash in the future if this obligation changes in accordance with some index (in this case the fair value of equity instruments), whereas equity instruments are not subsequently re-measured.

Comment

Although the liability representing a cash-settled share-based transaction shall be subsequently re-measured, one should take into consideration arguments developed in order to justify the use of the "grant date" for equity-settled share-based transactions. In particular, the statement that it is unlikely that subsequent changes in the fair value of an equity instrument to be issued could be considered as highly correlated with changes in the fair value of services received should also be applied to subsequent changes in the fair value of liabilities which are indexed on an equity instrument. In order to be consistent with the grant date approach to measurement of equity-settled share-based transactions, changes in the fair value of a liability representing a cash-settled share-based transaction should not affect the fair value of services received. Instead these fair value changes should rather be recognised as financial expense or income (not as an operational expense or income).

The application of this presentation approach for cash-settled share-based transactions would have the merit of making recognition of operational expenses related to share-based payment transactions comparable whether they are settled in cash or in equity instruments.

APPENDIX 2 : ACCOUNTING OBJECTIVES OF IFRS 2

(extract from the Report Back Paper presented at the Frankfurt NSS meeting in September 2009)

The analysis of how to apply the key accounting principles underlying IFRS 2 raises the issue of what the standard is setting out to portray. Once this objective has been determined, the key recognition and measurement principles should reflect a common accounting approach in line and consistent with this main objective.

The ANC working group noted two possible main accounting objectives that could be assigned to IFRS 2:

1. **To represent assets acquired by or services received** by the reporting entity as part of a share-based payment transaction irrespective of whether there is an identifiable payment made by the entity (or by a entity's shareholder or another entity of the group).
2. **To represent share-based payments** made by the reporting entity (or by an entity's shareholder or another entity of the group) irrespective of whether there is an identifiable service received by the entity.

These two objectives focus respectively on the two different facets of the exchange and may lead to different representations of the transaction.

For example, if we consider equity-settled schemes for employees including a vesting period, which are common transactions, services may be received from employees in the expectation of remuneration without ever actually giving rise to a payment e.g. if any of the conditions of payment are not satisfied. In a transaction with a 3 year vesting period an employee may leave after 2 years and 11 months and therefore not meet the payment condition. If we consider only the objective of representing the payment of the transaction, in this case nothing will be recognized because the vesting condition has not been satisfied.

Nevertheless, the employee may be perceived as having "performed" during his period of employment in the expectation of remuneration. He will have been present for the greater part of the vesting period and may therefore the entity has substantially received the required services. If we consider the objective of representing services received from the employee, it would appear logical to recognize as an expense the fair value of services received before the employee's departure.

This question has been analysed in particular in IFRS 2 BC 207 to 213 and the conclusions were that the objective of the standard should be to account for the services subsequently received, rather than the cost of the equity instruments issued (in the case of a equity-settled share-based payment transaction). However, there is an issue as to whether services should be recognized even when there is no payment, considering the two following aspects:

- Payment will be made only if all the service and performance conditions included in the initial contract agreed on by both parties at "grant date" are completely fulfilled; therefore, it may be considered that services received are closely linked to the fulfilment of these conditions; if these conditions are not completely fulfilled, one may consider that the related services have not been received; analysing services received in such a way could justify a focus on representing the payment of share-based payment transactions as the materialization of the rendering of the related services;
- Even if one may consider that services have been partially received, the absence of payment may be interpreted as these services being received for free; therefore these services should

not be recognized in the accounts as they would be measured for nil; one may question the consistency of such an interpretation with the accounting principle that equity instruments issued should not be re-measured; it might be argued that it is the services that are measured, not the instruments, and that the instruments have finally not been issued.

Current provisions of IFRS 2 may be confusing in this respect, as they may be interpreted as a mix of both approaches. For example, the recognition of services received is cancelled retrospectively when an employee does not fulfil service or non-market performance conditions. This accounting treatment may appear as aiming to represent the payment (through the kind of approach chosen in terms of measurement method determined at "grant date"), although it could be argued that the employee has at least partially received required services. The measurement principle applied to cash-settled share-based payment transactions appears consistent with the objective of representing the payment rather than the value of services received, especially as no distinction between the measurement of services received and fair value changes of the liability due to changes in the fair value of the equity instrument used as an index is required.

On the other hand, cancellation of share-based payment agreements by the employer does not result in the recognition of services received being cancelled retrospectively (their recognition is even accelerated), which does not appear consistent with the payment approach. Moreover, it is a core principle of IFRS 2 that an entity shall recognize services as they are received in a share-based payment transaction (see Accounting principle 1 above).

It therefore appears that a clarification of the accounting objectives of IFRS 2 is necessary.

In order to make IFRS 2 appear more principles based, one should make a clear choice between these two objectives and approaches and develop detailed provisions of the standard consistently. In particular, recognition and measurement principles should reflect the chosen objective and approach. As noted above, this includes clarification of how the notion of service received is understood.

APPENDIX 3 : DEFINITION OF THE NOTION OF SERVICES RECEIVED

(extract from the Report Back Paper presented at the Frankfurt NSS meeting in September 2009)

When applying the objective of representing services received it is necessary to consider what is meant by "service". Does the service consist of completing the required vesting period in full and being present on the vesting date? Or could it be that service implies presence and a form of performance over a period of time irrespective of whether the employee is still there on the vesting date? If the service relates to performance, could the performance be achieved in part or in full, even if an employee does not complete the vesting period? In other words might it be possible to consider service as performance not based exclusively on employee presence?

The ANC working group therefore considered the following possible definitions of the notion of service received:

1. Services are supposed to be received regularly on an accrual basis and are supposed to be proportional to the employee's presence; this definition seems consistent with the objective of representing service received and could facilitate the achievement of this objective;
2. Services are received if service (and performance) conditions are fully completed, which implies that they are received if the employee is present at the end of a vesting period, if any; this definition seems consistent with the objective of representing payment of share-based payment transactions.
3. Services received are an additional element not based on the sole presence of the employee during or at the end of a vesting period. This service would consist in an expected additional performance to be received during the presence of the employee and linked with productivity, quality of the work performed or other kind of motivation.

The ANC working group thought that such a definition would help in building a conceptual basis for the current provisions in IFRS 2 that result in applying a different accounting treatment when vesting/non vesting conditions are fulfilled or not, as well as when forfeiture/cancellation occurs. Such an approach would explain these different treatments by referring to the respective initiative and responsibility of the employees or employers in not respecting the conditions or terms of the initial contract agreed at "grant date". When the breach of the contract is at the initiative of the employee, it would justify the retrospective cancellation of recognized services on the grounds that this initiative evidenced a lack of motivation or performance from the employee that could be supposed to exist since the beginning of the vesting period. On the contrary, a breach at the initiative of the employer could justify not cancelling the recognition of services retrospectively on the grounds that this event does not prevent the employee from performing the expected service at least until the date of the breach.

Having said that, the ANC working group acknowledged that this approach may result in various application difficulties similar to those currently experienced. This creates difficulties in differentiating vesting and non vesting conditions, in particular non-market performance conditions where fulfilment could be under the control of the employee and market conditions that would be beyond his control. There would also be difficulties in making the distinction between events resulting in breach of the contract at the employee's or the employer's initiative. For example, some resignations may be caused by employers whereas some redundancies may be at the employee's demand. Trying to solve these issues may imply developing rules based approaches that would not be in line with the objective of the review project.

APPENDIX 4 : COMPARISON OF MEASUREMENT APPROACHES ILLUSTRATED BY NUMERICAL EXAMPLES

1. General conclusions drawn from the examples set out below

Objective of this note

The purpose of this note is to draw a comparison between the results of applying the « modified grant date » (MGD) and « Unit of Service » (UoS) methods using examples in the IG of IFRS 2 as well as additional versions of theses examples. These comparative examples set out to determine, with respect to the representation of services received, which of these methods:

- Leads to a more relevant accounting presentation;
- Is simpler to apply.

Moreover, another method, called « Payment » (P) in this note, is described with a view to representing payments actually made in the form of equity instruments. It is applied in each of the cases described for the other methods in order to illustrate the accounting consequences

Conclusions

In terms of complexity, the MGD method seems simpler to apply than the UoS method, even if it requires a re-estimation of the probability of vesting conditions being realised for interim periods, which is not necessary for the UoS method. On the other hand, the UoS method requires individual tracking of the realisation of vesting conditions by employees which can be complex to implement. However, contrary to the arguments set out in the BC (separate tracking of employees with different remuneration packages and the requirement to re-estimate the probability of vesting conditions being realised for the UoS method) these characteristics are not specific to the UoS method as the same difficulties have to be resolved when applying the MGD method.

The method "P" is equivalent to the MGD method and therefore of the same degree of complexity.

In terms of relevance of the information provided, the MGD method is close to the representation of « services paid » (but different to the method P where there are payment conditions which are not considered as vesting conditions). « Services received » are better represented by the UoS method although they could be approached by a « prospective » MGD method as presented in part 5.

Likewise, the extent of the potential volatility of amounts recognized in interim periods raises the question of the relevance of the MGD approach.

The method « P » represents « services paid » by building up a provision which may be reversed and released if the payment does not eventually take place.

2. IG Example 1 (example in which only service conditions are required)

<u>Conclusions drawn from IG Example 1(see following numerical examples):</u>

Complexity

The application of the UoS method is more complex in that it entails tracking the leaving dates of individual employees(on a day to day basis ?) whereas for the MGD and P methods it is sufficient to monitor the total number of employees (with the same vesting conditions) at any given date.

However, the argument relating to the complexity of tracking individual employees entitled to a variable number of instruments according to the status of each employee(BC 214) seems common to all of the methods, as it will have to carried out in all cases.

Conversely, the estimated forfeiture rate included in the grant date fair value is revised periodically for the MGD and P methods but not for the UoS. This revision makes the MGD and P methods more complex to apply in that respect.

Relevance of the results

The MGD and P methods give rise to greater variations than UoS when revising expense as a result of correcting forecasts for forfeiture. With regard to the P method these variations can be amplified where the non-realisation of market conditions gives rise ultimately to a cancellation of expense.

This revision makes the MGD method compatible with a “representation of payments made” approach + “definition of services received as all or nothing” illustrated by the P method, whereas the UoS method is only compatible with an “objective of representing services received” + “definition of services received on a pro rata basis” approach. In effect, when vesting conditions are limited to service conditions the MGD method gives the same overall result as the P method and is of an equivalent level of complexity.

However, the MGD method could be compatible with the second approach described if the periodic revision of the forfeiture rate was only carried out prospectively over the outstanding vesting period. But it would be less precise than the UoS method based on actual forfeitures reflecting the leaving dates of individual employees.

The periodic expense reported under the UoS method seems to follow a slightly decreasing trend. The variations under the MGD and P methods are irregular when the forecast for forfeiture is revised but are more regular when forecasts are confirmed.

<u>Numerical examples based on IG Example 1:</u>

<u>Assumptions:</u>

100 share options granted to each employee

Estimated fair value of option: 15€

500 employees initially

Required period of service: 3 years

Estimation of the number of employees leaving before the end of year 3 : 20%

Scenario 1: everything happens as expected

Result according to the MGD method:	for period	cumulated
Year 1 : 500 x 100 x 80% x15€ x 1/3 years =	200.000€	200.000€
Year 2 : 500 x 100 x 80% x15€ x 1/3 years =	200.000€	400.000€
Year 3 : 500 x 100 x 80% x15€ x 1/3 years =	200.000€	600.000€

Result according to P:

Year 1 : 500 x 100 x 80% x15€ x 1/3 years =	200.000€	200.000€
Year 2 : 500 x 100 x 80% x15€ x 1/3 years =	200.000€	400.000€
Year 3 : 500 x 100 x 80% x15€ x 1/3 years =	200.000€	600.000€

Result according to UoS:

Additional assumptions:

Employees leave on a regular basis (1/3 each year , on average in the middle of the year). The estimated number of UoS is therefore 400 employees (80%) x 3 years + 100 employees (20%) x 1,5 years = 1.350 UoS. The value of each UoS is therefore estimated as 500 x 100 x 80% x15€ = 600.000 / 1.350 = 444.44€.

	for period	cumulated
Year 1 : 467 + (33 x 0,5) x 444.44€ =	214.889€	214.889€
Year 2 : 433 + (34 x 0,5) x 444.44€ =	200.000€	414.889€
Year 3 : 400 + (34 x 0,5) x 444.44€ =	185.111€	600.000€

Scenario 2: the number of employees leaving is less than expected. 20employees leave the company in year 1, 22 in year 2 and 15 in year 3.

Result according to the MGD method:

Additional assumptions:

Year 1, the company revises its estimation of forfeiture over the three year period from 20% to 15%. Year 2, it revises the estimation from 15% to 12%.

	for period	cumulated
Year 1 : 500 x 100 x 85% x15€ x 1/3 years =	212.500€	212.500€
Year 2 : 500 x 100 x 88% x15€ x 2/3 years – 212.500€ =	227.500€	440.000€
Year 3 : (500 – 57) x 100 x 15€ - 440.000€ =	224500€	664.500€

Result according to P method:	for period	cumulated
Year 1 : 500 x 100 x 85% x15€ x 1/3 years =	212.500€	212.500€
Year 2 : 500 x 100 x 88% x15€ x 2/3 years – 212.500€ =	227.500€	440.000€
Year 3 : (500 – 57) x 100 x 15€ - 440.000€ =	224.500€	664.500€

Result according to UoS method:

Additional assumptions:

Employees leave on a regular basis over the vesting period (each year in the middle of the year on average). The initial value of each UoS estimated at 444.44€ is not modified.

	for period	cumulated
Year 1 : 480 + (20 x 0,5) x 444.44€ =	217.576€	217.576€
Year 2 : 458 + (22 x 0,5) x 444.44€ =	208.442€	426.018€
Year 3 : 443 + (15 x 0,5) x 444.44€ =	200.220€	626.238€

Scenario 3 (added): the number of employees leaving the company is more than expected. 40 employees leave the company in Year 1, 50 in Year2 and 30 in Year 3.

Result according to the MGD method:

Additional assumptions:

Year 1, the company revises its estimation of forfeiture over the three year period from 20% to 22%. Year 2, it revises its estimation from 22% to 25%.

	for period	cumulated
Year 1 : 500 x 100 x 78% x15€ x 1/3 years =	195.000€	195.000€
Year 2 : 500 x 100 x 75% x15€ x 2/3 years – 195.000€ =	180.000€	375.000€
Year 3 : (500 – 120) x 100 x 15€ - 375.000€ =	195.000€	570.000€

Resultat according to P method:	for period	cumulated
Year1 : 500 x 100 x 78% x15€ x 1/3 years =	195.000€	195.000€
Year 2 : 500 x 100 x 75% x15€ x 2/3 years – 195.000€ =	180.000€	375.000€
Year 3 : (500 – 120) x 100 x 15€ - 375.000€ =	195.000€	570.000€

Result according to UoS method:

Additional assumptions:

Employees leave on a regular basis over the vesting period (each year in the middle of the year on average). The initial value of each UoS estimated at 444.44€ is not modified.

	for period	cumulated
Year 1 : 460 + (40 x 0,5) x 444.44€ =	213.331€	213.331€
Year 2 : 410 + (50 x 0,5) x 444.44€ =	193.331€	406.662€
Year 3 : 380 + (30 x 0,5) x 444.44€ =	175.554€	582.216€

3. IG Example 2 (example where the required performance varies with the length of service)

Conclusions drawn from IG Example 2 (numerical examples below):

Complexity

In this example, the sequential approach to estimating the likelihood that performance conditions will be met (year by year in a binary approach)) applied to the MGD and P methods is highly simplified. As a result it appears simple to implement but this may be due to the nature of the example.

Conversely, the UoS method is very complex to apply, both in relation to formulating the assumptions (with respect to the forfeiture rate and the likelihood that performance conditions will be met, which are different for each period) and to the calculations to be made. This is in addition to the monitoring of individual employees' leaving dates, as previously mentioned.

Relevance of the results

It is questionable whether the result obtained under the MGD method, which gives rise to considerable fluctuations in periodic expense because of the retrospective re-estimation of the latter, enables an appropriate representation of services received.

Once again, it should be noted that the MGD and P methods lead to the recognition of an equivalent amount of expense, to the extent that no vesting conditions are included in the grant date fair value. The MGD method therefore confirms its compatibility with the« objective of representing payments made » + « the definition of services received as all or nothing ».This conforms our doubts with respect to its capacity(as currently applied) to represent services received.

The example is quite complex and does not bring out the respective consequences of applying the three methods when stable performance conditions are required throughout the vesting period. The following example was therefore conceived to overcome this shortcoming.

Numerical examples based on IG Example 2:

Assumptions:

100 share options granted to each employee

Estimated fair value of option: 30€

500 employees initially

Required performance: the profits of the company must increase by 18% in one year, or by 13% on average over two years, or by 10% on average over three years.

Scenario: At the end of Year 1, 30 employees have left and the profits of the entity have increased by 14%. The entity expects the objective of an average increase of profit of 13% over two years will be attained and that a further 30 employees will leave in Year 2.

At the end of Year 2, a further 28 employees have left and the profits have increased by 10% in Year 2. The entity expects the objective of a 10% average annual increase in profits over three years will be attained and that a further 25 employees will leave in Year 3.

At the end of Year 3 , a further 23 employees have left and the profit has increased by 8% in Year 3. The objective of increasing profit on average by 10% per year over three years is achieved.

Result according to the MGD method:	for period	cumulated
Year 1 : (500 – 60) x 100 x 30€ x 1/2 years =	660.000€	660.000€
Year 2 : (500 – 83) x 100 x 30€ x 2/3 years – 660.000€ =	174.000€	834.000€
Year 3 : (500 – 81) x 100 x 30€ - 834.000€ =	423.000€	1.257.000€

Result according to the P method:	for period	cumulated
Year 1 : (500 – 60) x 100 x 30€ x 1/2 years =	660.000€	660.000€
Year 2 : (500 – 83) x 100 x 30€ x 2/3 years – 660.000€ =	174.000€	834.000€
Year 3 : (500 – 81) x 100 x 30€ - 834.000€ =	423.000€	1.257.000€

Result according to the UoS method:

Additional assumptions:

Employees leave on a regular basis over the vesting period (each year in the middle of the year on average).

It appears necessary to make assumptions with respect to the forfeiture rate and the likelihood of attaining periodic objectives.

- Namely the assumption that 33 employees leave the entity in Year 1, 34 in Year 2 and 33 in Year 3 (assumption of example 1).
- Also the assumption that the performance objective has a 40% chance of being attained over 1 year, 55% over 2 years and 70% over 3 years.

It also appears that the estimated value of UoS must be different from one year to another.

For Year 1, the fair value of options granted, the expected number of UoS and the resulting value of a UoS would be respectively:

- Fair value = (500 – 33) x 100 x 30€ x 40% = 560.400€;
- Number of UoS = 467 + (33 x 0,5) = 483,5;
- Value of a UoS = 560.400 / 483.5 = 1159,05€.

For Year 2 , the calculations would be respectively:

- Fair value = (500 – 67) x 100 x 30€ x 55% = 714.450€;
- Number of UoS = (433 x 2 ans) + (67 x 1 an) = 933
- Value of a UoS = 714.450 / 933 = 765,76€

For Year 3, the calculations would be respectively:

- Fair value = (500 – 100) x 100 x 30€ x 70% = 840.000€;
- Number of UoS = (400 x 3 ans) + (100 x 1,5 ans) = 1350
- Value of a UoS = 840.000 / 1350 = 622,22€

	for period	cumulated
Year 1 : 470 + (30 x 0,5) x 1159.05€ =	562.139€	562.139€
Year 2 : 442 + (28 x 0,5) x 765.76€ =	349.187€	911.326€
Year 3 : 419 + (23 x 0,5) x 622.22€ =	267.866€	1179.192€

3. IG Example 2 b (added) : example where a single performance (non-market) is required over a period of service

Conclusions drawn from IG example 2 b (numerical examples below):

Complexity

In this example the MGD and P approaches require a periodic re-estimate of the likelihood of attaining the objective. On the other hand, the UoS method requires closer tracking of leaving dates (as previously indicated).

Relevance of the results

Once again it is questionable whether the result obtained under the MGD method, which gives rise to considerable fluctuations in periodic expense because of changes of assumption relating to the expected achievement of objectives and rate of forfeiture from one year to the next(in this example as both of these assumptions increase over time, recognized expense also increases significantly), enables an appropriate representation of services received.

It should again be noted that the methods MGD and P give rise to an equivalent amount of expense to the extent that no vesting conditions are included in the grant date fair value. The MGD method therefore confirms its compatibility with the« objective of representing payments made » + « the definition of services received as all or nothing ».This conforms our doubts with respect to its capacity(as currently applied) to represent services received.

It should be noted that if a performance condition (market or non-market) not associated with a service condition were introduced into the example, it would give rise to differences between the MGD and P methods, both in the measurement of the grant date fair value of the options granted(included in the MGD method and excluded from P),and due to the fact that a possible cancellation under P would lead to the writing back all expense when such a condition is not ultimately fulfilled.

Thus, the example does not bring out the respective consequences of applying the three methods when the fulfilment of performance conditions(market or non-market) not associated with a service condition is required. The following example was therefore conceived to overcome this shortcoming.

Numerical examples based on IG Example 2 b:

Assumptions:

100 share options granted to each employee

Estimated fair value of option: 30€

500 employees initially

Required performance (non-market): each employee must generate an added value of 100€ over a maximum of three years and be in service at the end of the period.

The initial estimate is that 20% of employees will leave before completing the three year period and that 75% of those remaining will achieve the objective.

Scenario: At the end of Year 1, 30 employees have left. The remaining employees have achieved on average 30% of the individual objective(none of them have exceeded it).The entity expects a further 30 employees to leave in Year 2 and 30in Year 3 and that the individual objective will be attained by 70% of those remaining.

At the end of Year 2, a further 28 employees have left and the remaining employees have achieved 70% of the individual objective (none of them have exceeded it). The entity expects a further 27 employees to leave in Year 3 and that the individual objective will be achieved by 80% of those remaining.

At the end of Year 3, a further 22 employees have left and 350 employees remaining have achieved the objective.

Result according to the MGD method:	for period	cumulated
Year 1 : (500 – 90) x 100 x 30€ x 70% x 1/3 years =	287.000€	287.000€
Year 2 : (500 – 85) x 100 x 30€ x 80% x 2/3 – 287.000k€ =	377.000€	664.000€
Year 3 : 350 x 100 x 30€ - 664.000€ =	386.000€	1.050.000€

Result according to method P:	for period	cumulated
Year 1 : (500 – 90) x 100 x 30€ x 70% x 1/3 years =	287.000€	287.000€
Year 2 : (500 – 85) x 100 x 30€ x 80% x 2/3 – 287.000€ =	377.000€	664.000€
Year 3 : 350 x 100 x 30€ - 664.000€ =	386.000€	1.050.000€

Result according to the UoS method:

Additional assumptions:

Employees leave on a regular basis over the vesting period (each year in the middle of the year on average).

The fair value of the options granted, the expected number of UoS and the resulting value of a UoS will therefore be:

- Fair value = (500 – 100) x 100 x 30€ x 75% = 900.000€;
- Number of UoS = 400 x 3 + (100 x 1,5) = 1350;
- Value of UoS = 900.000 / 1350 = 666,67€.

	for period	cumulated
Year 1 : 470 + (30 x 0,5) x 666.67€ =	323.335€	323.335€
Year 2 : 442 + (28 x 0,5) x 666.67€ =	304.002€	627.337€
Year 3 : 420 + (22 x 0,5) x 666.67€ =	287.335€	914.672€

4. IG Example 2 c (added) : example where non-market performance and a market condition are required over a period of service

In general, a non-market condition should be considered as a condition which the counterparties to the agreement(employees, corporate officers) can choose to meet and therefore correspond to a service which they can provide. A market condition should be considered as a condition which the counterparty cannot influence significantly and which should therefore be included in the grant date fair value of the consideration exchanged and not re-valued subsequently.

Conclusions drawn from IG example 2 c (numerical examples below):

Complexity

In this example the MGD approach requires a periodic re-estimation of the likelihood of the objective being attained. The Uos method requires a detailed tracking of employees' leaving dates (as previously indicated).

Relevance of the results

Once again it is questionable whether the result obtained under the MGD method, which gives rise to considerable fluctuations in periodic expense because of changes of assumption relating to the expected achievement of objectives and rate of forfeiture from one year to the next (in this example as both of these assumptions increase over time, recognized expense also increases significantly), enables an appropriate representation of services received.

In this case , the MGD and P methods lead to different amounts of expense, irrespective of whether the market condition is met or not. The MGD method appears in this case to be between the representation of a payment made and service received. It is questionable what it actually represents in this case(estimation of the value of services rendered by employees in the expectation of receiving a payment?).

Numerical examples based on IG Example 2 c :

Assumptions:

100 share options granted to each employee

Estimated fair value of option: 30€

500 employees initially

Required performance (non-market): each employee must generate an added value of 100€ over a maximum of three years and be in service at the end of the period.

The initial estimate is that 20% of employees will leave before completing the three year period and that 75% of those remaining will achieve the objective.

Required market performance: the value of the company's shares must reach a level X. The likelihood of achieving this target is estimated at the grant date to be 75%. As a result the value of each option is adjusted(roughly) to 22,50€ in the MGD and UoS approaches.

Scenario: At the end of Year 1, 30 employees have left. The remaining employees have achieved on average 30% of the individual objective(none of them have exceeded it).The entity expects a further 30 employees to leave in Year 2 and 30in Year 3 and that the individual objective will be attained by 70% of those remaining

At the end of Year 2, a further 28 employees have left and the remaining employees have achieved 70% of the individual objective (none of them have exceeded it). The entity expects a further 27 employees to leave in Year 3 and that the individual objective will be achieved by 80% of those remaining.

At the end of Year 3, a further 22 employees have left and 350 employees remaining have achieved the objective. Scenario (a) the market condition is fulfilled (b) the market condition is not fulfilled.

Result according to the MGD method:	for period	cumulated
Year 1 : (500 – 90) x 100 x 22,50€ x 70% x 1/3 years =	215.250€	215.250€
Year 2 : (500–85) x 100 x 22,50€ x 80% x 2/3 – 215250€ =	282.750€	498.000€
Year 3 : 350 x 100 x 22,50€ - 498.000€ =	289.500€	787.500€

Result according to the P method :

Additional assumption:

The likelihood of the market condition being achieved is 65% at the end of Year 1 and 60% at the end of Year 2.

	for period	cumulated
Year 1 : (500 – 90) x 100 x 30€ x 70% x 65% x 1/3 ans =	186.550€	186.550€
Year 2 : (500 – 85) x 100 x 30€ x 80% x 60% x2/3 ans		
– 186.550€ =	211.850€	398.400€
Year 3 scenario (a): 350 x 100 x 30€ - 398.400€ =	651.600€	1.050.000€
Year 3 scenario (b): 0€ - 398.400€ =	-398.400€	0€

Result according to the UoS method:

Additional assumptions:

Employees leave on a regular basis over the vesting period (each year in the middle of the year on average).

The fair value of the options granted, the expected number of UoS and the resulting value of a UoS will therefore be:

- Fair value = (500 – 100) x 100 x 22,50€ x 75% = 675.000€;
- Number of UoS = 400 x 3 + (100 x 1,5) = 1350;
- Value of a UoS = 675.000 / 1350 = 500€.

	for period	cumulated
Year 1 : 470 + (30 x 0,5) x 500€ =	242.500€	242.500€
Year 2 : 442 + (28 x 0,5) x 500€ =	228.000€	470.500€
Year 3 : 420 + (22 x 0,5) x 500€ =	215.500€	686.000€

5. IG Example MGD « prospective » approach: example in which MGD is not applied retrospectively to bring it closer to the UoS method

In this simulation the aim is to make the MGD method non-retrospective to see whether it produces results similar to the UoS method whilst remaining simpler to apply. In this approach, the calculations made for a period will not be cancelled or modified in a subsequent period. The calculation for a period becomes independent and "watertight" in respect of other periods.

Conclusions drawn from IG Example MGD prospective approach :

Complexity

This example confirms that the MGD prospective approach requires a periodic re-estimation of the likelihood of the objective being attained whilst the UoS method requires a detailed tracking of employees' leaving dates. The MGD prospective approach appears simpler to apply.

Relevance of the results

The results obtained with the MGD prospective approach appear closer to those obtained with the UoS method and quite different to those obtained with the P method (except in the rather complex case of the IG Example 2 where there are significant variations in the expected likely outcome due to the periodic review of objectives), whilst the amount of expense remains more sensitive to changes in assumption in respect of the degree of achievement of objectives and changes in the forfeiture rate from one period to another. The MGD prospective approach provides a better representation of services received although not as precisely as the UoS method. It could therefore be considered as a compromise if the objective is to represent services received and the UoS method is considered too complex to apply.

Numerical examples illustrating the MGD prospective approach :

IG Example 1, Scenario 1: no change

Result according to the MGD prospective approach	for period	cumulated
Year 1 : 500 x 100 x 80% x 15€ x 1/3 years =	200000€	200.000€
Year 2 : 500 x 100 x 80% x 15€ x 1/3 years =	200000€	400.000€
Year 3 : 500 x 100 x 80% x 15€ x 1/3 years =	200000€	600.000€

Reminder of result according to MGD method:	for period	cumulated
Year 1 : 500 x 100 x 80% x15€ x 1/3 years =	200.000€	200.000€
Year 2 : 500 x 100 x 80% x15€ x 1/3 years =	200.000€	400.000€
Year 3 : 500 x 100 x 80% x15€ x 1/3 yearss =	200000€	600.000€

Reminder of result according to UoS method:	for period	cumulated
Year 1 : 467 + (33 x 0,5) x 444.44€ =	214.889€	214.889€
Year 2 : 433 + (34 x 0,5) x 444.44€ =	200.000€	414.889€
Year 3 : 400 + (34 x 0,5) x 444.44€ =	185.111€	600.000€

IG Example 1, Scenario 2: The revised forfeiture rates over the three year period are applied prospectively: 20% in Year 1, 15% in Year 2 et 12% in Year 3.

Result according to the MGD prospective approach	for period	cumulated
Year 1 : 500 x 100 x 80% x 15€ x 1/3 years =	200000€	200.000€
Year 2 : 500 x 100 x 85% x 15€ x 1/3 years =	212500€	412.500€
Year 3 : 500 x 100 x 88% x 15€ x 1/3 years =	220000€	632.500€

Reminder of result according to MGD method:	for period	cumulated
Year 1 : 500 x 100 x 85% x15€ x 1/3 years =	212.500€	212.500€
Year 2 : 500 x 100 x 88% x15€ x 2/3 year – 212.500€=	227.500€	440.000€
Year 3 : (500 – 57) x 100 x 15€ - 440.000€ =	224500€	664.500€

Reminder of result according to UoS method:	for period	cumulated
Year 1 : 480 + (20 x 0,5) x 444.44€ =	217.576€	217.576€
Year 2 : 458 + (22 x 0,5) x 444.44€ =	208.442€	426.018€
Year 3 : 443 + (15 x 0,5) x 444.44€ =	200.220€	626.238€

IG Example 1, Scenario 3 (added): The estimated forfeiture rates are 20% in Year 1, 22% in Year 2 and 25% in year 3.

Result according to the MGD prospective approach	for period	cumulated
Year 1 : 500 x 100 x 80% x15€ x 1/3 years =	200.000€	200.000€
Year 2 : 500 x 100 x 78% x15€ x 1/3 years =	195.000€	395.000€
Year 3 : 500 x 100 x 75% x15€ x 1/3 years =	187.500€	582.500€

Reminder of result according to MGD method:	for period	cumulated
Year 1 : 500 x 100 x 78% x15€ x 1/3 years =	195.000€	195.000€
Year 2 : 500 x 100 x 75% x15€ x 2/3 ans – 195.000€=	180.000€	375.000€
Year 3 : (500 – 120) x 100 x 15€ - 375.000€ =	195000€	570.000€

Reminder of result according to UoS method:	for period	cumulated
Year 1 : 460 + (40 x 0,5) x 444.44€ =	213.331€	213.331€
Year 2 : 410 + (50 x 0,5) x 444.44€ =	193.331€	406.662€
Year 3 : 380 + (30 x 0,5) x 444.44€ =	175.554€	582.216€

IG Example 2: It is necessary to establish an assumption for the initial forfeiture rate in Year 1 i.e.34 employees. At the end of Year 1, it is expected that 60 employees will leave in Year 2. At the end of Year 2, it is expected that 83 employees will leave in Year 3. It is also necessary to adopt the assumptions relating to the likelihood of achieving the performance objective as in the UoS approach i.e. 40% in Year 1, 55% in Year 2 and70% in Year 3.

Result according to the MGD prospective approach	for period	cumulated
Year 1 : (500 – 34) x 100 x 30€ x 40% =	599.200€	599.200€
Year 2 : (500 – 60) x 100 x 30€ x 55% x 1/2 years =	363.000€	962.200€
Year 3 : (500 – 83) x 100 x 30€ x 70% x 1/3 years =	291.900€	1.254.100€

Reminder of result according to MGD method:	for period	cumulated
Year 1 : (500 – 60) x 100 x 30€ x 1/2 years =	660.000€	660.000€
Year 2 : (500 – 83) x 100 x 30€ x 2/3 years – 660.000€ =	174.000€	834.000€
Year 3 : (500 – 81) x 100 x 30€ - 834.000€ =	423.000€	1.257.000€

Reminder of result according to UoS method:	for period	cumulated
Year 1 : 470 + (30 x 0,5) x 1159.05€ =	562.139€	562.139€
Year 2 : 442 + (28 x 0,5) x 765.76€ =	349.187€	911.326€
Year 3 : 419 + (23 x 0,5) x 622.22€ =	267.866€	1179.192€

IG Example 2 b:

Result according to the MGD prospective approach	for period	cumulated
Year 1 : 500 x 100 x 30€ x 80% x 75% x 1/3 years =	300.000€	300.000€
Year 2 : 500 x 100 x 30€ x 82% x 70% x 1/3 years =	287.000€	587.000€
Year 3 : 500 x 100 x 30€ x 83% x 80% x 1/3 years =	332.000€	919.000€

Reminder of result according to MGD method:	for period	cumulated
Year 1 : (500 – 90) x 100 x 30€ x 70% x 1/3 years =	287.000€	287.000€
Year 2 : (500 – 85) x 100 x 30€ x 80% x 2/3 – 287.000€ =	377.000€	664.000€
Year 3 : 350 x 100 x 30€ - 664.000€ =	386.000€	1.050.000€

Reminder of result according to UoS method	for period	cumulated
Year 1 : 470 + (30 x 0,5) x 666.67€ =	323.335€	323.335€
Year 2 : 442 + (28 x 0,5) x 666.67€ =	304.002€	627.337€
Year 3 : 420 + (22 x 0,5) x 666.67€ =	287.335€	914.672€

IG Example 2 c:

Result according to the MGD prospective approach	for period	cumulated
Year 1 : 500 x 100 x 22,50€ x 80% x 75% x 1/3 years=	225.000€	225.000€
Year 2 : 500 x 100 x 22,50€ x 82% x 70% x 1/3 years=	215.250€	440.250€
Year 3 : 350 x 100 x 22,50€ x 83% x 80% x 1/3 years=	249.000€	689.250€

Reminder of result according to MGD method:	for period	cumulated
Year 1 : (500 – 90) x 100 x 22,50€ x 70% x 1/3 years =	215.250€	215.250€
Year 2 : (500–85) x 100 x 22,50€ x 80% x 2/3 – 215000€ =	282.750€	498.000€
Year 3 : 350 x 100 x 22,50€ - 498.000€ =	289.500€	787.500€

Result according to the UoS method:	for period	cumulated
Year 1 : 470 + (30 x 0,5) x 500€ =	242.500€	242.500€
Year 2 : 442 + (28 x 0,5) x 500€ =	228.000€	470.500€
Year 3 : 420 + (22 x 0,5) x 500€ =	215.500€	686.000€

APPENDIX 5 : Units of service method: Illustration of the proposed treatment of modifications and cancellations 1/2

ASSUMPTIONS Vesting period = 3 years Unit of service – UoS : 1 year Value of UoS (10000/3) = 3333

	Agreement at initial grant date Beginning period 1(CU)	*Advantageous Modification* End period 2 (CU)	*Disadvantageous Modification* End period 2 (CU)	*Cancellation without compensation* End period 2 (CU)	*Cancellation with immediate compensation* End period 2 (CU)
Case A = Fair value (FV) rise since initial grant date					
FV of instruments initially granted at the date of modification/cancellation (m/c)	10000	100000	100000	100000	100000
FV of instruments/compensation granted through m/c	n/a	120000	80000	0	99000
Difference in FV due to m/c	0	+20000	-20000	-100000	-1000
Recognized services expenses					
Recognized expenses at end period 2 (2 periods x initial value of UoS)	6667	6667	6667	6667	6667
Recognized expenses in period 3					
1 period x initial value of UoS	3333	3333	3333	3333	3333
Difference due to m/c	0	+20000	-20000	-100000	-1000
Total recognized expenses in period 3	3333	23333	-16667	-96667	2333 (1)
Total recognized expenses (3 periods)	**10000**	**30000**	**-10000**	**-90000**	**9000**

(1) in fact recognized immediately at the end of period 2

APPENDIX 5 : Units of service method: Illustration of the proposed treatment of modifications and cancellations 2/2

ASSUMPTIONS Vesting period = 3 years Unit of service – UoS : 1 year Value of UoS (10000/3) = 3333

	Agreement at initial grant date Beginning period 1(CU)	*Advantageous Modification* End period 2 (CU)	*Disadvantageous Modification* End period 2 (CU)	*Cancellation without compensation* End period 2 (CU)	*Cancellation with immediate compensation* End period 2 (CU)
Case B = Fair value (FV) fall since initial grant date					
FV of instruments initially granted at the date of modification/cancellation (m/c)	10000	1000	1000	1000	1000
FV of instruments/compensation granted through m/c	n/a	10000	100	0	2000
Difference in FV due to m/c	0	+9000	-900	-1000	+1000
Recognized services expenses					
Recognized expenses at end period 2 (2 periods x initial value of UoS)	6667	6667	6667	6667	6667
Recognized expenses in period 3					
1 period x initial value of UoS	3333	3333	3333	3333	3333
Difference due to m/c	0	+9000	-900	-1000	+1000
Total recognized expenses in period 3	3333	12333	2433	2333	4333 (1)
Total recognized expenses (3 periods)	**10000**	**19000**	**9100**	**9000**	**11000**

APPENDIX 6 : Payment method: Illustration of the proposed treatment of modifications and cancellations 1/2

ASSUMPTIONS Vesting period = 3 years

	Agreement at initial grant date Beginning period 1(CU)	*Advantageous Modification* End period 2 (CU)	*Disadvantageous Modification* End period 2 (CU)	*Cancellation without compensation* End period 2 (CU)	*Cancellation with immediate compensation* End period 2 (CU)
Case A = Fair value (FV) rise since initial grant date					
FV of instruments initially granted at the date of modification/cancellation (m/c)	10000	100000	100000	100000	100000
FV of instruments/compensation granted through m/c	n/a	120000	80000	0	99000
Difference in FV due to m/c	0	+20000	-20000	-100000	-1000
Remuneration expenses					
Recognized expenses at end period 2 (2 periods x 10000 / 3)	6667	6667	6667	6667	6667
Remuneration expenses in period 3					
FV of instruments granted minus remuneration recognized end period 2	3333	113333	73333	-6667	92333 (1)
Total recognized expenses (3 periods)	**10000**	**120000**	**80000**	**0**	**99000**
Alternative : only initial grant date fair value + FV difference due to m/c		*10000+20000*	*10000-20000*	*10000-100000*	*10000-1000*
FV of instruments granted minus remuneration recognized end period 2	3333	23333	-16667	-96667	2333 (1)
Total recognized expenses (3 periods)	**10000**	**30000**	**-10000**	**-90000**	**9000**

Conclusion on alternative approach: same problem of negative amounts as for the Unit of Service method (with the three

identified avenues)

APPENDIX 6 : Payment method: Illustration of the proposed treatment of modifications and cancellations 2/2

ASSUMPTIONS Vesting period = 3 years

	Agreement at initial grant date Beginning period 1(CU)	*Advantageous Modification* End period 2 (CU)	*Disadvantageous Modification* End period 2 (CU)	*Cancellation without compensation* End period 2 (CU)	*Cancellation with immediate compensation* End period 2 (CU)
Case B = Fair value (FV) fall since initial grant date					
FV of instruments initially granted at the date of modification/cancellation (m/c)	10000	1000	1000	1000	1000
FV of instruments/compensation granted through m/c	n/a	10000	100	0	2000
Difference in FV due to m/c	0	+9000	-900	-1000	+1000
Remuneration expenses					
Recognized expenses at end period 2 (2 periods x 10000 / 3)	6667	6667	6667	6667	6667
Remuneration expenses in period 3					
FV of instruments granted minus remuneration recognized end period 2	3333	3333	-6567	-6667	-4667 (1)
Total recognized expenses (3 periods)	**10000**	**10000**	**100**	**0**	**2000**
Alternative : only initial grant date fair value + FV difference due to m/c		*10000+9000*	*10000-900*	*10000-1000*	*10000+1000*
FV of instruments granted minus remuneration recognized end period 2	3333	12333	2433	2333	4333 (1)
Total recognized expenses (3 periods)	**10000**	**19000**	**9100**	**9000**	**11000**

Conclusion on the main approach “cancel and replace”. In case of FV fall and m/c, several cases of negative amounts (in the last period) appear