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Joseph L. Sclafani
Executive Vice President and Controller

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Ms. Kimberley Crook
Project Manager
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Re: IASB Exposure Draft – ED 2 Share-based Payment

Dear Ms. Crook:

J.P. Morgan Chase & Co. appreciates the opportunity to provide its views on the International Accounting Standards Board's ("IASB") Exposure Draft of its proposed International Financial Reporting Standard, Share-based Payment ("IFRS").

We support the efforts of the IASB in their work towards convergence of accounting standards worldwide and development of principle-based accounting standards. The proposed IFRS on share-based payments offers a challenging opportunity to achieve these objectives.

As requested, please find our comments in response to the IASB's questions on its Exposure Draft of the proposed IFRS.

If you have any questions or would like to discuss the attached comments, please do not hesitate to contact me or David M. Morris at (212) 648-0377.

Very truly yours,

/s/Joseph L. Sclafani

J.P. Morgan Chase & Co. ? 270 Park Avenue, Floor 28, New York, NY 10017-2070
Telephone: 212 270 7559 ? Facsimile: 212 270 9589
joseph.sclafani@chase.com

**RESPONSE TO QUESTIONS ON THE IASB EXPOSURE DRAFT—
ED 2 SHARE-BASED PAYMENT**

Question 1
Paragraphs 1 - 3 of the draft IFRS set out the proposed scope of the IFRS. There are no proposed exemptions, apart from for transactions within the scope of another IFRS. Is the proposed scope appropriate? If not, which transactions should be excluded and why?

The proposed scope of the IFRS is appropriate. There should be no exceptions for any share-based payment transactions.

Question 2
Paragraphs 4 - 6 of the draft IFRS propose requirements for the recognition of share-based payment transactions, including the recognition of an expense when the goods or services received or acquired are consumed. Are these recognition requirements appropriate? If not, why not, or in which circumstances are the recognition requirements inappropriate?

All share-based payment transactions should be recorded at fair value as determined under an appropriate valuation method. When an entity issues equity instruments in return for goods or services, the issuing entity should record what has been received in exchange for consideration given. A liability should be recorded when equity-based transactions can be settled in cash and equity should be affected for equity-settled transactions. However, if payment is not made because the transaction was not completed, then expense should not be recognized.

Question 3
For an equity-settled share-based payment transaction, the draft IFRS proposes that, in principle, the entity should measure the goods or services received, and the corresponding increase in equity, either directly, at the fair value of the goods or services received, or indirectly, by reference to the fair value of the equity instruments granted, whichever fair value is more readily determinable (paragraph 7). There are no exemptions to the requirement to measure share-based payment transactions at fair value. For example, there are no exemptions for unlisted entities. Is this measurement principle appropriate? If not, why not, or in which circumstances is it not appropriate?

The use of the fair value method in measuring equity-settled share-based payment transactions is the appropriate method. However, there are as yet no reliable methods to properly value equity instruments granted by unlisted entities. Until appropriate models are developed, flexibility should be permitted.

Question 4
If the fair value of the goods or services received in an equity-settled share-based payment transaction is measured directly, the draft IFRS proposes that fair value should be measured at the date when the entity obtains the goods or receives the services (paragraph 8). Do you agree that this is the appropriate date at which to measure the fair value of the goods or services received? If not, at which date should the fair value of the goods or services received be measured? Why?

The fair value of equity-settled share-based payment transactions should be measured on the date that the parties involved have a mutual understanding of the terms and conditions of the transaction. Whether the grantee is an employee or nonemployee, the underlying premise of the transaction is the same—the entity is willing to exchange value (i.e., stock options) for value received (i.e., goods or services) as determined on the contract (grant) date. Therefore, the transaction should be valued at the date the terms of the transaction are known.

Question 5
If the fair value of the goods or services received in an equity-settled share-based payment transaction is measured by reference to the fair value of the equity instruments granted, the draft IFRS proposes that the fair value of the equity instruments granted should be measured at grant date (paragraph 8). Do you agree that this is the appropriate date at which to measure the fair value of the equity instruments granted? If not, at which date should the fair value of the equity instruments granted be measured? Why?

We agree that the grant date is the appropriate date to use to measure the fair value of goods or services exchanged for equity-settled share-based payments to employees as well as nonemployees. It is generally at the grant date that the parties involved have a mutual understanding of the terms and conditions of the award granted.

Question 6
For equity-settled transactions with parties other than employees, the draft IFRS proposes a rebuttable presumption that the fair value of the goods or services received is more readily determinable than the fair value of the equity instruments granted (paragraphs 9 and 10). Do you agree that the fair value of the goods or services received is usually more readily determinable than the fair value of the equity instruments granted? In what circumstances is this not so?

Yes, generally the fair value of goods or services received is more readily determinable when negotiated with third-party suppliers. For transactions with nonemployees, there is usually an independent and competitive market place where pricing is representative of the fair value of the goods or services being offered.

Question 7
For equity-settled transactions with employees, the draft IFRS proposes that the entity should measure the fair value of the employee services received by reference to the fair value of the equity instruments granted, because the latter fair value is more readily determinable (paragraphs 11 and 12). Do you agree that the fair value of the equity instruments granted is more readily determinable than the fair value of the employee services received? Are there any circumstances in which this is not so?

Yes, the fair value of equity instruments granted is more readily determinable. Determination of the fair value of the services an employee renders is difficult to quantify since the benefits received by the employing entity have an intangible quality that cannot be quantified.

Question 8
Paragraphs 13 and 14 of the draft IFRS propose requirements for determining when the counterparty renders service for the equity instruments granted, based on whether the

counterparty is required to complete a specified period of service before the equity instruments vest. Do you agree that it is reasonable to presume that the services rendered by the counterparty as consideration for the equity instruments are received during the vesting period? If not, when are the services received, in your view?

Yes, the compensation costs attributable to the fair value of equity instruments granted should be recognized in the financial statements during the required service period.

Question 9

If the services received are measured by using the fair value of the equity instruments granted as a surrogate measure, the draft IFRS proposes that the entity should determine the amount to attribute to each unit of service received, by dividing the fair value of the equity instruments granted by the number of units of service expected to be received during the vesting period (paragraph 15). Do you agree that if the fair value of the equity instruments granted is used as a surrogate measure of the fair value of the services received, it is necessary to determine the amount to attribute to each unit of service received? If not, what alternative approach do you propose? If an entity is required to determine the amount to attribute to each unit of service received, do you agree that this should be calculated by dividing the fair value of the equity instruments granted by the number of units of services expected to be received during the vesting period? If not, what alternative method do you propose?

Although the attribution method proposed in the IFRS allocates expense in a systematic and rational manner, it will be cumbersome to apply, especially for larger entities where equity instruments are granted to tens of thousands of employees. The straight-line method also provides for a reasonable allocation of expense over the service period, but it is a simpler method to apply. Both methods provide rational ways to recognize expense over time. Other than that, there is no difference to indicate that one alternative is better than the other. Whichever method is used, it only provides a formula for timing the recognition of the expense estimate, which should be trued up at maturity to reflect only the cost of the equity instruments that actually vest and are issued.

Question 10

In an equity-settled share-based payment transaction, the draft IFRS proposes that having recognised the services received, and a corresponding increase in equity, the entity should make no subsequent adjustment to total equity, even if the equity instruments granted do not vest or, in the case of options, the options are not exercised (paragraph 16). However, this requirement does not preclude the entity from recognising a transfer within equity, i.e. a transfer from one component of equity to another. Do you agree with this proposed requirement? If not, in what circumstances should an adjustment be made to total equity and why?

No. First, transfers should not be made within equity unless there is justification to do so. Second, and more importantly, the total compensation expense to be recognized over time should equal the fair value of the equity instruments at grant date times the <u>actual</u> number of equity instruments issued at the vesting date. Only the value of the equity instruments actually issued under the performance criteria should be recognized in the financial statements since this is representative of the value given up by the entity. Therefore, in the case of forfeitures due to the failure to achieve the required service and/or performance conditions, expense previously recognized for those forfeited instruments should be reversed so that expense relating to only vested and issued equity instruments is ultimately recognized in earnings. In the case of options, once the options vest, the expense should be fixed and not reversed if the options are not exercised.

A simple way of viewing a forfeiture event is to compare it to a cash transaction. Assume an entity offers a cash award to an employee if he or she remains with the entity for a three-year period. If the employee stays for the three-year period, then he or she will receive the cash bonus payment. The entity will record the expense over the three-year "vesting" period. If an employee leaves after two years, then he or she does not receive the cash payment and the entity would adjust the expense accrual, accordingly, for the lower cash amount to be paid (i.e., reversal of the expense accrual at date of forfeiture). The accounting for the compensation expense that is related to an equity-settled award should be the same as for a cash award. There is no basis for compensation expense to be recognized differently depending on the form of the compensation payment.

Question 11
The draft IFRS proposes that the entity should measure the fair value of equity instruments granted, based on market prices if available, taking into account the terms and conditions of the grant (paragraph 17). In the absence of a market price, the draft IFRS proposes that the entity should estimate the fair value of options granted, by applying an option pricing model that takes into account various factors, namely the exercise price of the option, the life of the option, the current price of the underlying shares, the expected volatility of the share price, the dividends expected on the shares (where appropriate) and the risk-free interest rate for the life of the option (paragraph 20). Paragraph 23 of the proposed IFRS explains when it is appropriate to take into account expected dividends. Do you agree that an option pricing model should be applied to estimate the fair value of options granted? If not, by what other means should the fair value of the options be estimated? Are there circumstances in which it would be inappropriate or impracticable to take into account any of the factors listed above in applying an option pricing model?

Yes, the market has demonstrated that option-pricing models are the appropriate tools to price options. Consistent with market practice, the value of employee stock options should be measured using an option-pricing model. However, no one particular option-pricing model should be mandated. Current models were developed to price short-term marketable options and, recently, models have been used to price longer-dated marketable options. However, existing models do not incorporate all the variables needed to produce accurate valuations of employee stock options, because these models exclude such components as forfeiture and nontransferability, among others conditions. Entities should be encouraged to experiment with modifications to the basic option-pricing models in order to produce more reliable valuations of their employee stock options based on the terms and conditions of the options granted.

Also, additional guidance should be provided to the extent that such guidance would establish a base that could be built on as option-pricing models evolve to address the difficulties in valuing employee stock options. Existing option-pricing models, such as the Black Scholes and Binomial models, are widely used and provide a relatively simple and consistent valuation. Designating these models as a base standard will not produce accurate valuations, but will provide a level of consistency and comparability in the results reported. Further, this approach would provide entities with the foundation that could be used to develop enhanced option-pricing models that would produce more reliable valuations.

Question 12
If an option is non-transferable, the draft IFRS proposes that the expected life of an option rather than its contracted life should be used in applying an option-pricing model (paragraph 21). The draft IFRS also proposes requirements for options that are subject to vesting conditions and therefore cannot be exercised during the vesting period (paragraph 22). Do you agree that replacing an option's contracted life with its expected life when applying an option pricing model is

an appropriate means of adjusting the option's fair value for the effects of non- transferability? If not, do you have an alternative suggestion? Is the proposed requirement for taking into account the inability to exercise an option during the vesting period appropriate?

Nontransferability is a variable that should be incorporated into the option-pricing model. However, current option-pricing models do not take this into consideration and, therefore, at this point, do not produce reliable valuations of employee stock options. Use of the expected life in the option-pricing model does produce a reduction in value. However, it is not reflective of the diminution in value resulting from nontransferability. Efforts should continue in modifying the basic option-pricing model until a reliable model is developed to accurately reflect the terms of employee stock options. In the interim to provide consistency and comparability among reporting entities, the IASB should prescribe an appropriate discount or haircut to be applied by all entities in valuing employee stock options to reflect the reduction in value due to nontransferability.

Question 13
If a grant of shares or options is conditional upon satisfying specified vesting conditions, the draft IFRS proposes that these conditions should be taken into account when an entity measures the fair value of the shares or options granted. In the case of options, vesting conditions should be taken into account either by incorporating them into the application of an option pricing model or by making an appropriate adjustment to the value produced by such a model (paragraph 24). Do you agree that vesting conditions should be taken into account when estimating the fair value of options or shares granted? If not, why not? Do you have any suggestions for how vesting conditions should be taken into account when estimating the fair value of shares or options granted?

Conditions which place restrictions on equity instruments that normally do not exist for equity issued in the market place should be taken into consideration when estimating the fair value of equity instruments granted. Three restrictions normally included in equity-settled share-based awards to employees are nontransferability, forfeiture and performance targets.

- When the ability to transfer equity instruments is restricted, the market has clearly demonstrated that such nontransferable instruments (e.g., unregistered shares) trade at significant discounts to the price of readily transferable instruments. This discount should be reflected in the award's value.

- Employees forfeit the right to receive the equity-settled share-based award if they terminate employment prior to completion of the required service period, the value of the equity instruments on grant date should reflect this risk value. The fact that the award can be lost if the employee does not fulfill the service or performance requirements is a restrictive feature embedded in the terms of the award and, therefore, a component of its value.

- If awards vest only if designated performance targets are achieved (e.g., a targeted common stock price, or other targeted objective, such as achieving sales, levels of production or income, or productivity goals), the potential for achieving the target directly affects the probability of vesting. Although difficult if not impossible to value objectively, the risk associated with meeting the target should be incorporated into the valuation model.

Question 14
For options with a reload feature, the draft IFRS proposes that the reload feature should be taken into account, where practicable, when an entity measures the fair value of the options granted. However, if the reload feature is not taken into account in the measurement of the fair value of the

options granted, then the reload option granted should be accounted for as a new option grant (paragraph 25). Is this proposed requirement appropriate? If not, why not? Do you have an alternative proposal for dealing with options with reload features?

No, option-pricing techniques have not yet evolved sufficiently enough to reliably value "plain vanilla" employee stock options. Therefore, they have not sufficiently evolved to reliably value more complex instruments. Valuing each reload event as a new grant provides a workable, interim solution until the time that option-pricing techniques evolve to the point that incorporating reload features into the model and producing reliable measurement can be demonstrated.

Question 15

The draft IFRS proposes requirements for taking into account various features common to employee share options, such as non-transferability, inability to exercise the option during the vesting period, and vesting conditions (paragraphs 21- 25). Are there other common features of employee share options for which the IFRS should specify requirements?

Other factors that need to be considered in the valuation process for employee stock options will depend on the terms and conditions of each particular issuance. However, the factors proposed for inclusion by the IFRS (i.e., nontransferability, forfeiture and performance targets) are the predominant features in most stock option grants.

Question 16

The draft IFRS does not contain prescriptive guidance on the estimation of the fair value of options, consistently with the Board's objective of setting principles-based standards and to allow for future developments in valuation methodologies. Do you agree with this approach? Are there specific aspects of valuing options for which such guidance should be given?

Yes. Current option-pricing models do not take into consideration all variables and scenarios particular to stock options granted to employees. Therefore, it would not be appropriate at this time to prescribe an exact model since current models available do not assure accurate fair value results. Entities should be encouraged to experiment with modifications to the current option-pricing models to produce more reliable valuations of employee stock options incorporating terms and conditions typical to stock options granted.

Question 17

If an entity reprices a share option, or otherwise modifies the terms or conditions on which equity instruments were granted, the draft IFRS proposes that the entity should measure the incremental value granted upon repricing, and include that incremental value when measuring the services received. This means that the entity is required to recognise additional amounts for services received during the remainder of the vesting period, i.e. additional to the amounts recognised in respect of the original option grant. Example 3 in Appendix B illustrates this requirement. As shown in that example, the incremental value granted on repricing is treated as a new option grant, in addition to the original option grant. An alternative approach is also illustrated, whereby the two grants are averaged and spread over the remainder of the vesting period. Do you agree that the incremental value granted should be taken into account when measuring the services received, resulting in the recognition of additional amounts in the remainder of the vesting period? If not, how do you suggest repricing should be dealt with? Of the two methods illustrated in Example 3, which is more appropriate? Why?

The modification of an award that makes it more valuable is effectively an exchange of the original award for a new award with greater value. The incremental value to the employee from the issuance of a new award should be measured and accounted for as incremental expense. We believe that the more appropriate method for recognizing the incremental expense is the second alternative. This alternative provides for a more rational method of expense recognition since the incremental cost due to the repricing is combined with the unamortized cost of the original grant and spread evenly over the remaining vesting period of the modified award.

Question 18
If an entity cancels a share or option grant during the vesting period (other than a grant cancelled by forfeiture when the vesting conditions are not satisfied), the draft IFRS proposes that the entity should continue to recognise the services rendered by the counterparty in the remainder of the vesting period, as if that grant had not been cancelled. The draft IFRS also proposes requirements for dealing with any payment made on cancellation and/or a grant of replacement options, and for the repurchase of vested equity instruments. Are the proposed requirements appropriate? If not, please explain why not and provide details of your suggested alternative approach.

Cancellation of a share or option grant before vesting is complete is effectively an accelerated vesting of the award and, therefore, all unrecognized expense should be recognized upon cancellation. It is not appropriate to continue to recognize expense over the remaining vesting period since the entity no longer expects to receive any services in return for the awards granted. However, cash payments made in exchange for vested awards should reduce equity in an amount not to exceed the fair value of the respective award. Any excess over that amount should be recognized as additional expense.

Question 19
For cash-settled share-based payment transactions, the draft IFRS proposes that the entity should measure the goods or services acquired and the liability incurred at the fair value of the liability. Until the liability is settled, the entity should remeasure the fair value of the liability at each reporting date, with any changes in value recognised in the income statement. Are the proposed requirements appropriate? If not, please provide details of your suggested alternative approach.

Yes. Because these awards are cash-settled, the ultimate settlement amount is not known until the settlement value is fixed. Accordingly, the liability must be remeasured each period to reflect changes in its value.

Question 20
For share-based payment transactions in which either the entity or the supplier of goods or services may choose whether the entity settles the transaction in cash or by issuing equity instruments, the draft IFRS proposes that the entity should account for the transaction, or the components of that transaction, as a cash-settled share-based payment transaction if the entity has incurred a liability to settle in cash, or as an equity-settled share-based payment transaction if no such liability has been incurred. The draft IFRS proposes various requirements to apply this principle. Are the proposed requirements appropriate? If not, please provide details of your suggested alternative approach.

The substance of the transaction as well as the past settlement practices should dictate the proper accounting for an award. When past history has shown that the grantor or grantee (whomever has the option to select the means of settlement) has chosen stock to settle the transaction, then these amounts should appropriately be recorded equity. If past history proves that cash is typically the form of settlement, then a liability should be recorded for such awards and then remeasured each period to reflect changes in its value over the required service period.

Question 21

The draft IFRS proposes that an entity should disclose information to enable users of financial statements to understand:

(a) the nature and extent of share-based payment arrangements that existed during the period,
(b) how the fair value of the goods or services received, or the fair value of the equity instruments granted, during the period was determined, and
(c) the effect of expenses arising from share-based payment transactions on the entity's profit or loss.

Are these disclosure requirements appropriate? If not, which disclosure requirements do you suggest should be added, deleted or amended (and how)?

We support the efforts of the IASB to provide users of financial statements with the information necessary to enable full understanding and analysis of the impact of granting equity-based awards. The disclosures proposed in the IFRS achieve this objective with the following exceptions:

a) Disclosure to describe the method used to produce the fair value of equity-based awards should be required. Additionally, if the option-pricing model used is modified to incorporate other variables into the valuation, then information should be provided to describe the nature and effect of the modifications.

b) The IFRS disclosures shown in paragraph 48 (a)(ii)-(v) and (b) should not be required. The information to be disclosed is in support of the assumptions used in the valuation process. Other assets and liabilities recorded on the balance sheet are carried at fair value, but disclosure of the underlying bases for their valuation assumptions is not required.

Question 22

The draft IFRS proposes that an entity should apply the requirements of the IFRS to grants of equity instruments that were granted after the publication date of this Exposure Draft and had not vested at the effective date of the IFRS. It also proposes that an entity should apply retrospectively the requirements of the IFRS to liabilities existing at the effective date of the IFRS, except that the entity is not required to measure vested share appreciation rights (and similar liabilities) at fair value, but instead should measure such liabilities at their settlement amount (i.e. the amount that would have been paid on settlement of the liability had the counterparty demanded settlement at the date the liability is measured). Are the proposed requirements appropriate? If not, please provide details of your suggestions for the IFRS's transitional provisions.

The transition provisions of the IFRS should require that all awards granted, modified, or settled as of the beginning of the year that the IFRS is adopted be accounted for on a prospective basis. This should also apply to liabilities incurred after the effective date of adoption.

Question 23

The draft IFRS proposes a consequential amendment to IAS 12 (revised 2000) *Income Taxes* to add an example to that standard illustrating how to account for the tax effects of share-based payment transactions. As shown in that example, it is proposed that all tax effects of share-based payment

transactions should be recognised in the income statement. Are the proposed requirements appropriate?

No. The initial tax benefit recorded is based on the compensation expense recognized in the period. Incremental tax benefits arise based on actions by third parties (e.g., the employees) at future dates based on market values. As such, they result from equity-related transactions unrelated to the operating activities of the entity and, consequently, should be accounted for as equity transactions.

Question 24

In developing the Exposure Draft, the Board considered how various issues are dealt with under the US standard SFAS 123 *Accounting for Stock- Based Compensation* , as explained further in the Basis for Conclusions. Although the draft IFRS is similar to SFAS 123 in many respects, there are some differences. The main differences include the following.

(a) Apart from transactions within the scope of another IFRS, the draft IFRS does not propose any exemptions, either from the requirement to apply the IFRS or from the requirement to measure share-based payment transactions at fair value. SFAS 123 contains the following exemptions, none of which are included in the draft IFRS:
- **employee share purchase plans are excluded from SFAS 123, provided specified criteria are met, such as the discount given to employees is relatively small;**
- **SFAS 123 encourages, but does not require, entities to apply its fair value measurement method to recognise transactions with employees; entities are permitted to apply instead the intrinsic value measurement method in Accounting Principles Board Opinion No. 25 *Accounting for Stock Issued to Employees* (paragraphs BC70- BC74 in the Basis for Conclusions give an explanation of intrinsic value); and**
- **unlisted (non-public) entities are permitted to apply the minimum value method when estimating the value of share options, which excludes from the valuation the effects of expected share price volatility (paragraphs BC75- BC78 in the Basis for Conclusions give an explanation of minimum value).**

(b) For transactions in which equity instruments are granted to employees, both SFAS 123 and the draft IFRS have a measurement method that is based on the fair value of those equity instruments at grant date. However:
- **under SFAS 123, the estimate of the fair value of an equity instrument at grant date is not reduced for the possibility of forfeiture due to failure to satisfy the vesting conditions, whereas the draft IFRS proposes that the possibility of forfeiture should be taken into account in making such an estimate.**
- **under SFAS 123, the transaction is measured at the fair value of the equity instruments issued. Because equity instruments are not regarded as issued until any specified vesting conditions have been satisfied, the transaction amount is ultimately measured at the number of vested equity instruments multiplied by the fair value of those equity instruments at grant date. Hence, any amounts recognised for employee services received during the vesting period will be subsequently reversed if the equity instruments granted are forfeited. Under the draft IFRS, the transaction is measured at the deemed fair value of the employee services received. The fair value of the equity instruments granted is used as a surrogate measure, to determine the deemed fair value of each unit of employee service received. The transaction amount is ultimately measured at the number of units of service received during the vesting period multiplied by the deemed fair value per unit of service. Hence, any amounts recognised for employee services received are not subsequently reversed, even if the equity instruments granted are forfeited.**

(c) If, during the vesting period, an entity settles in cash a grant of equity instruments, under SFAS 123 those equity instruments are regarded as having immediately vested, and therefore the amount of compensation expense measured at grant date but not yet recognised is recognised immediately at the date of settlement. The draft IFRS does not require immediate recognition of an expense but instead proposes that the entity should continue to recognise the services received (and hence the resulting expense) over the remainder of the vesting period, as if that grant of equity instruments had not been cancelled.

(d) SFAS 123 does not specify a measurement date for transactions with parties other than employees that are measured at the fair value of the equity instruments issued. Emerging Issues Task Force Issue 96- 18 *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services* requires the fair value of the equity instruments issued to be measured at the earlier of (i) the date a performance commitment is reached or (ii) the date performance is complete. This date might be later than grant date, for example, if there is no performance commitment at grant date. Under the draft IFRS, the fair value of the equity instruments granted is measured at grant date in all cases.

(e) SFAS 123 requires liabilities for cash-settled share appreciation rights (SARs) to be measured using an intrinsic value measurement method. The draft IFRS proposes that such liabilities should be measured using a fair value measurement method, which includes the time value of the SARs, in the same way that options have time value (refer to paragraphs BC70- BC81 of the Basis for Conclusions for a discussion of intrinsic value, time value and fair value).

(f) For a share-based payment transaction in which equity instruments are granted, SFAS 123 requires realised tax benefits to be credited direct to equity as additional paid-in capital, to the extent that those tax benefits exceed the tax benefits on the total amount of compensation expense recognised in respect of that grant of equity instruments. The draft IFRS, in a consequential amendment to IAS 12 (revised 2000) *Income Taxes*, proposes that all tax effects of share-based payment transactions should be recognised in profit or loss, as part of tax expense.

For each of the above differences, which treatment is the most appropriate? Why? If you regard neither treatment as appropriate, please provide details of your preferred treatment.

Our views on the questions above are as follows:

(a) If accounting guidance is to be principle-based, then all stock-based compensation plans should follow the same guidance, except in the case where the transaction may be immaterial to the entity's financial statements. All share-based payment transactions should result in expense computed based on the fair value of the awards granted and recognized over the period that services are rendered. This principle should be required of all public and nonpublic entities in order to promote the comparability of financial statements. Because a nonpublic entity's stock price is not available, a key measure in the option-pricing model is missing; therefore, option values cannot be objectively measured. There is no assurance that the IASB approach would be significantly more reliable in determining fair value versus the minimum value method prescribed by SFAS 123.

(b) The expected forfeitures should be incorporated into the estimate of fair value. As discussed in Question 13 above, if the employee does not fulfill the service requirement, then the award is lost. Since forfeitability is embedded into the terms of the award, it is a component of the award's value and should be included in the option-pricing model. However, inclusion of the forfeitability feature into the option-pricing model would be difficult if not impossible to determine. Accordingly, compensation expense to be recognized over the required service period should be equal to the fair value of the options at grant date times the actual number of options that actually vest, and expense previously recognized for options that are forfeited should be reversed.

(c) Cash payments made to settle an equity-based award is an accelerated vesting event and the remaining expense related to those instruments should be immediately recognized in the financial statements at that time.

(d) We disagree with the guidance in Issue 96-18. We concur with the IFRS proposal that equity-based transactions, whether with employees or nonemployees, should be measured at the same date-- the date of grant. The only exception would be when all the terms of the transaction are not known at the date of grant. The value would be fixed when all the terms are known.

(e) Cash-settled SAR's have effectively the same characteristics as options (i.e., value is based on changes in value of the underlying entity's stock) and, therefore, should be accounted for at fair value using an option-pricing model. The value calculated at grant date should be remeasured each period for valuation changes to be recognized in the statement of income.

(f) Initial tax benefits based on compensation expense should be recorded in the income statement. However, incremental tax benefits arising in the future, based on actions by third parties, are equity-related transactions and, therefore, should be recorded in equity.

Question 25
Do you have any other comments on the Exposure Draft?

None.