THE VOICE OF BUSINESS

CL 164

INTERNATIONAL ACCOUNTING STANDARDS BOARD

ED 2 : SHARE – BASED PAYMENT

CBI RESPONSE **March 2003**

INTRODUCTION AND SUMMARY OF CBI POSITION

1. The CBI welcomes the opportunity to respond to the Board's consultation.

2. In response to the UK Accounting Standards Board's previous consultation in 2000, CBI members opposed the proposed deduction from profits on the grounds that the cost of share-based schemes was a cost properly attributable to shareholders which shareholders had authorised at the time of giving approval to the scheme. A minority of CBI members continue to take this view and strongly challenge the arguments that the cost of share schemes is a cost of the company which should be charged in the Profit and Loss Account. Some of these CBI members would, however, support some form of disclosure of the cost appearing as a note in the accounts, if capable of being calculated with sufficient rigour and reliability.

3. However, in the light of calls for more prudent and conservative accounting practices following Enron and WorldCom, and in recognition that this latest proposal is for an international accounting standard, and not solely a UK standard, which will therefore achieve a degree of international harmonisation on an issue which has proved very controversial, most CBI members now accept that executive share option and share – based schemes have a cost that should be recognised in the profit and loss account.

4. The exemption that many companies seek is in respect of Government approved all employee share schemes, on two grounds - not being remuneration like executive share schemes and in support of public policy of promoting wider share ownership. Whilst regulators such as the IASB and ASB have due right and authority to promulgate accounting standards, it would be very helpful if they could demonstrate that they have taken public policy considerations into account, when reaching their conclusions and recommendations. This is particularly important in the context of the appropriate accounting treatment for share options and share based payment schemes, and the possible exclusion of all employee share schemes on public policy grounds of promoting wider share ownership, since these proposals have proved so controversial over many years.

Clive Edrupt – Company Affairs
DL: + 44 (0) 20 7395 8042 DF: +44 (0) 20 7836 1114 E: clive.edrupt@cbi.org.uk

CBI Centre Point 103 New Oxford Street London WC1A 1DU
T: +44 (0)20 7379 7400 F: +44 (0)20 7240 1578 E: enquiry.desk@cbi.org.uk W: www.cbi.org.uk

5. **However whatever the form of any accounting standard that may be adopted, it is vitally important that there is genuine international agreement and harmonisation on this issue, so that there is a level playing field for UK and European companies with other companies internationally, in particular the US and Japan. Introduction of any new international accounting standard should therefore only take place subject to, and conditional upon, similar requirements being introduced in the United States and Japan for their companies as part of the convergence project.**

6. The support for recognising a cost is conditional on there being a rigorous and reliable regime to measure the cost in accordance with general accounting principles. We remain uncertain whether valuation methods do exist which will satisfy this test of reliability, particularly share based schemes in unlisted companies. There is also the issue of lack of tradeability of share options, and having regard to the fact that the Black Scholes model was not developed with long term share options in mind, but short–term freely tradeable options. Empirical evidence shows that there are problems with using Black-Scholes and binomial models for these options.

7. We support the declared aim that accounting standards should set out the principles to be applied and not be a detailed set of rules. Companies should therefore be free to establish valuations of their employee share option grants in the most appropriate way as more sophisticated and better models are developed. Any method used would, of course, need to be justified with the auditors.

8. We are pleased that the new proposals now use the date of grant for the valuation of an employee share – based scheme, and not the date of vesting or the date of exercise or some other date. However, we believe that the relevant date in respect of non-employee share transactions should also be the date on which the agreement to issue shares is entered into and not the date that the transaction completes. The principle behind the standard should be to value the instrument issued and this will consequently be on its grant irrespective of the recipient.

9. A further concern is in respect of unlisted companies. We accept that the basic accounting approach should apply to all companies, both listed and unlisted. However we have highlighted above the difficulties unlisted companies in particular will face in making a reliable assessment of the cost of such schemes for incorporation into the accounts. In addition, the cost of compliance for smaller companies may well be unduly burdensome. It may be necessary to include more guidance for such entities and it is important that the Board gives priority to the development of a simpler method under rules equivalent to the UK's FRSSE.

10. As noted above, many CBI members consider that there should be an exemption for Government approved all employee share schemes, as is presently the case in the United States. There are two aspects to this argument. First, whilst executive share schemes are very much tailored to the individual's remuneration package and performance, and so can more readily be regarded as a cost which should be charged to the P&L this is not the case with all employee schemes. In contrast to executive schemes, all employee schemes are provided as a motivation for employees to identify with the success of the company. Employees are not bound to participate in such schemes, they are voluntary for individual employees to join if they wish and, unlike the schemes specially designed for executives, they are not tailored to individual performance and other specific criteria. Accordingly, all employee schemes are not remuneration, and should not be considered an expense of the business.

11. Moreover, the UK Government, like many others, has a policy of promoting saving, as well as wider share ownership, and promotes such policy by granting tax advantages to approved share schemes. Such schemes are therefore not remuneration and should not be subject to a charge in the P&L account. If the cost of such schemes is now to be a deduction from the company's profits, the future of such share schemes will be in severe doubt. Companies could well be discouraged from creating new schemes for their employees. Smaller companies in particular are likely to review the feasibility of providing such schemes, because of the significant management time and professional fees incurred in calculating the cost of such schemes, in addition to the impact on the P&L. In this eventuality, the UK Government's target of doubling the number of companies offering all employee share scheme would most probably fail, as well as the probability of closure of many existing schemes.

12. Many companies and organisations are anxious to see international convergence on accounting standards. We therefore welcome the convergence project between FASB in the United States and the IASB. The exposure draft asked for comments on the fact that the proposals have no exemptions, while the equivalent FASB ones (FAS 123) exclude certain employee share ownership trusts and share purchase plans. These exclusions currently carve out Section 401(k) plans and the equally popular Section 423 plans on the grounds that these are "non-compensatory" i.e. not in return for services. We consider that the IASB should adopt a similar exemption.

13. In summary, there is now acceptance amongst most CBI members of the appropriateness of a charge to the P&L account of the cost of executive share schemes on the ground that they are remuneration. However very many of those members consider that Government approved all-employee schemes should not be regarded as remuneration and should be exempted.
There are also public policy grounds for exemption to encourage employee share schemes in support of wider share ownership.
Many CBI members also remain unconvinced that the cost of executive schemes can be reliably calculated for accounting purposes using generally accepted accounting principles. Black–Scholes and other existing methods were not designed for this purpose, and unlisted companies will face particular difficulties. Much more work and guidance on valuation is needed before any standard is implemented.
Whatever the final form of the any accounting standard adopted, similar accounting rules should exist for US and Japanese companies, so that there is genuine international harmonisation and comparability in financial reporting, and a level playing field for UK companies.

14. We respond below to the specific consultation questions.

RESPONSES TO CONSULTATION QUESTIONS

IASB 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?

As noted in the Introduction and Summary, the UK and other governments seek to encourage wider share ownership amongst employees and therefore there are public policy arguments for excluding government approved share purchase schemes open to all employees. We also consider that all employee schemes where membership is voluntary are not remuneration nor an employment cost, like executive schemes.

We consider that the application of the standard to unlisted entities will require clear and simple guidance, so that entities are not required to incur significant costs in taking professional advice. We have highlighted in the Introduction and Summary the difficulties of measuring the cost, particularly for unlisted companies, and the need for practical and workable guidance for companies to enable them to measure the cost in a rigorous and reliable manner in accordance with general accounting principles.

Consideration should also be given for an exemption for companies which are wholly owned subsidiaries in respect of the issue of shares in the parent company. While the consolidated financial statements will include the full charge and the increase in equity, it seems unnecessary and onerous to mandate that this cost be allocated between the relevant employers as a notional inter-company transaction.

IASB 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?

Yes, the recognition requirements are appropriate.

IASB 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) 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 measurement principle should be to measure the equity instrument issued. Pragmatically, we accept that measuring the goods or services received, rather than the equity instrument issued, may be more appropriate in certain circumstances.

IASB 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?

No, we do not agree that the measurement date is when the entity obtains the goods or receives the services. On the basis of the principles applying to employee share based schemes, the measurement date should be the date the agreement is entered into. This is the date the company is contractually committed to issue the shares subject to the satisfactory delivery of the goods or services concerned. It is also consistent with the measurement date if the fair value of the equity instruments is used as the basis.

IASB 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?

Yes we agree with the proposal that the measurement date should be the date of grant.

IASB 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 that 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 that the fair value of the equity instruments granted?
In what circumstances is this not so?

Yes, we agree with this approach. The price of goods and services will often be readily determinable.

However, in the venture capital industry, it is common for advisors to be granted options on unlisted companies to be exercised if and when the company is listed or acquired by another party. Similarly, there will be many occasions when the supplier is akin to a joint venture partner, probably giving technical advice or developing a special product for his customer in return for a share of the success of the venture. In these cases, the fair value of the goods and services may not be readily determinable.

IASB Question 7

For equity-settled transaction with employees, the draft IFRS proposed that the entity should be measure 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 that the fair value of the employee services received? Are there any circumstances in which this is not so?

We broadly agree, though this presumption should be rebuttable.

IASB 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?

Generally we agree that the services rendered by the counterparty as consideration for the equity instruments will be received during the vesting period, but would not wish to see an inflexible rule that always required the cost to be expensed over the vesting period. The principle should be to recognise the expense over the period being rewarded.

IASB 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 service expected to be received during the vesting period? If not, what alternative method do you propose?

We are concerned that if fewer employees leave than was anticipated, this can result in the total charge to the profit and loss account being greater than the fair value of the options granted. The converse can also apply leading to the charge to the profit and loss account being less than the fair value of the options granted. A straight line amortisation of the fair value of the option might be more preferable. This would be consistent with the argument that a financial instrument (share or option) has been issued and so must be recognised and then expensed as the services that it is paying for are received.

IASB 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, ie 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?

Yes.

IASB 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 option 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?

We agree with this approach. However, as indicated above, it is vitally important that there is practical and workable guidance for companies, and avoidance as far as possible of the need for companies to take specific expensive professional advice to make the necessary calculations.

IASB 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?

We support the proposed accounting treatment.

IASB 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 option 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 share or option granted?

We support the proposed accounting treatment. However, it is worth mentioning that vesting conditions always include subjective assumptions.

IASB Question 14

For option 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?

We support the proposed accounting treatment.

IASB 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 (paragraph 21-25).

Are there other common features of employee share options for which the IFRS should specify requirements?

The draft standard should allow leeway for future developments in the valuation of employee share option grants. ED 2 explicitly identifies the Black-Scholes and binomial models and it further specifies the six key input variables that should be applied. The major problem with mandating inputs based on an existing pricing model to value employee share options is that the current models were developed to value something entirely different, i.e. they were developed to estimate the price of short-term, freely tradable options.

IASB 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 not 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?

We support this approach. The publication of some general implementation guidance from which companies make a judgement as to how they will implement the principles set out in the standard. We do not support a more prescriptive rule based approach.

IASB 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 the incremental value when measuring the services received. This means that the entity is required to recognise additional amounts of services received during the remainder of the vesting period, ie 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?

We support the proposed accounting treatment.

Of the two methods, we support the first approach as it will be simpler to implement. The alternative approach has the advantage of smoothing the effect of repricing but this seems to be contrary to current accounting principles. We suspect that the suggested approach will have the effect of deterring companies from repricing options.

IASB 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.

If an option is cancelled, then it is difficult to see how it can still be regarded as giving rise to future services received by the company - future service units are zero. Moreover, as noted in ED 2, there will often be a payment or new scheme to replace the cancelled scheme. If there is a new scheme this will be expensed to reflect the service received in the future. If, as suggested in our response to Q 9 above, a straight line amortisation of the fair value of the option is adopted, then the balance outstanding might be written off.

IASB 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 settles, 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.

This treatment involves applying an options-pricing model at **each** balance sheet date until the liability is settled, whereas with an actual option an options-pricing model is only used once. We would prefer the approach in ASB UITF 25, which assumes that the share price ruling on the balance sheet date will remain unaltered for the duration of the instrument and thus the liability is calculated without reference to option-pricing models but is instead an intrinsic value approach.

IASB 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 of 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.

We support the proposed accounting treatment.

IASB Question 21

The draft IFRS proposes that an entity should disclose information to enable user 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 payments 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)?

Whilst we broadly support a disclosure approach to accountability, there are too many disclosure requirements, in the current ED 2. There needs to be a more proportionate approach to disclosure to ensure that the overall number and extent of disclosures are not so voluminous as to be read by no one.

The descriptive disclosures proposed in paragraph 48 (a), (c) and (d) are excessive. Entities should simply be required to summarise the main quantitative assumptions. A reader will be able to judge the appropriateness of these assumptions by comparison with peer companies without the need for superfluous justification by the company concerned.

For any company with a large number of employees owning share options in the company, the disclosures proposed in paragraph 46(c) of the weighted average share price at the date of exercise would excessive, as options could be exercised almost continually throughout the year. Disclosure of the average share price for the year should be sufficient. If this requirement is retained, it would be clearer if it were worded 'the weighted average **of the** share price at the date of exercise'. Paragraph 46(d) could also require onerous and excessive disclosures.

The disclosure required by paragraph 52(b) appears unnecessary. If a cash-settled, rather than equity-settled, share-based payment transaction has been accounted for appropriately, why require disclosure of the difference between the actual charge and the charge that would have arisen had the transaction been structured differently, namely had it been structured as an equity-settled share-based payment transaction?

IASB 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 the 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 (ie 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.

Companies who are able to ascertain the figures should have the option to make retrospective application if they wish to do so. Otherwise we support the proposed accounting treatment.

IASB 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?

We support the proposed accounting treatment.

IASB 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 transaction 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 are relatively small;**

- **SFAS 123 encourages, but does not require, entities to apply its fair value measurement method to recognise transaction 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 BC75-BC74 in the Basis for Conclusions give an explanation of minimum 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 transaction in which equity instruments are granted to employee, both SFAS 123 and the draft IFRS have a measurement method that is based on fair value of those equity instruments at grant date.

However:

- **Under SFAS 123, the estimate of the fair value of an estimate instrument at grant date is not reduced for the possibility for 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 at grant date. Hence, any amounts recognised for employee services received during the vesting period will be subsequently reversed if the equity instruments granted for 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 services 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 96-19 *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 require 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 on 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 compensations 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 treatments as appropriate, please provide details of your preferred treatment.

In respect of the differences listed in (a) first and third bullet points, (b) first bullet point and (c) above, we consider that the US solutions have practical advantages, as well as promoting convergence. For the others, we generally prefer the draft IFRS.

IASB Question 25

Do you have any other comments on the Exposure Draft?

The IASB should work closely with the US FASB in order to achieve harmonisation on this key issue. Recent studies show that out of TOP-500 global companies, 146 are European and all of them have employee stock option schemes in place. It is important to ensure that companies complying with IAS and IFRS, such as UK and European listed companies, are not put at a competitive disadvantage compared to their global rivals.