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CHAIRMAN

CL 147

TUESDAY, MARCH 11 , 2003

AB/JC/MP

N° 146

Sir David TWEEDIE

IASB Chairman

30 Cannon Street
LONDON, EC4M 6XH

UNITED KINGDOM

Dear David,

I am pleased to provide you with the comments of the Conseil National de la Comptabilité on the IASB exposure draft on the accounting for share based payments.

These comments result from a working group including participants from companies, audit firms and regulatory agencies. The detailed answers to IASB's questions are attached herewith.

You will find hereafter in this letter the main features of our position dealing with the following six main topics :

- We support the objective of the standard to recognise an expense when the services are consumed,
- We however strongly believe that its valuation causes major difficulties, one of them dealing with reliability of measurement (§86 of IASB Framework),
- We are of the opinion that employee share purchase plans should be excluded from the scope of the standard,
- We do not support your view on the accounting on the consequences of vesting conditions on the option prices, and would consider an approach similar to the one of FAS123,
- We favour an easier accounting approach for the modifications of the terms and conditions of option plans,
- We are concerned that the type of expense arising from share based payment transactions might not be compatible with the Framework (§94) ; and the proposed accounting treatment could result in future deviations

Overall, we consider that the difficulties arising from the measurement of share based transactions are central to the project.

The main goal of the project is to give an accurate view of the expenses of a company. This would lead to a unique standard among the other IASB standards, as it deals with the definition of an expense with no change in the net assets of a company. Yet, expenses are generally considered as a result of a variation of assets or liabilities. In this context, due to the uncertainties surrounding the measurement of the expense, it is questionable if comparability and accuracy of the income statement could be reached when expenses are measured with different methods from one company to the other.

We therefore consider that, when stock options relate to a quoted and liquid market (or in more general terms, when they are reliably measurable) the value so determined should be accounted for in the income statement although some companies are reluctant to such an accounting treatment . On the contrary, when no reliable value of the option granted can be determined, a clear information in the notes to the financial statements on the nature, the number of the options granted, the range of cost, …etc would be more advisable than an actual recognition of an highly questionable cost of the transaction, even recognising that comparability among companies would then be made more difficult.

Recognition of an expense

We agree with the principle that all transactions settled by the delivery of equity instruments should be recognised. Indeed, it cannot be considered that the equity instruments are given for free.

Valuation

We strongly question the conclusions of the Exposure Draft as to the measurement of share-based payment transactions, and notably the ones related to stock option plans because:

The proposed models need to be adapted by each user

The only valuation models that are referred to in the ED are the Black and Scholes and Binomial models.
Because these two models are not precise enough and are suited only for traded and liquid equity instruments, market operators use internally developed models to evaluate options on non traded equity instruments. Basically, what these models do is mitigate the results of standard models, such as Binomial or Black and Scholes, by taking the impact of the lack of liquidity into account.
According to the experts of our working group, it leads to significant discrepancies among the derived methods. In other words they believe three different experts would come up with three different valuations for the cost of the same option plan. However, these experts noted that for listed companies with high volumes of transactions, adaptations of the models lead to estimates within close ranges, although these options remain not negotiable.

The proposed model is not suitable for non-liquid markets

One of the main hypotheses for both models is that there is a liquid market, both for the option and the underlying equity instrument. It does not appear that any academic model exists that provides valuation for options on non traded or non liquid instruments.

The proposed model only gives ranges of values

Finally, these internally developed models do not come up with a definite price for the option, but with a range of estimates. IAS 39 (§69 and 101) acknowledges the fact that there are "equity instruments that do not have quoted price in an active market, and whose fair value cannot be reliably measured". It appears that many of the instruments granted in stock option plans are part of the financial instruments related to the category set by paragraph 101 of IAS 39.

As a conclusion, with regard to the IASB Framework (§ 86 and 31 to 38), we wonder whether the expense arising from share based payment transactions should be considered as a reliable measurement or estimate, notably when they are dealing with non liquid financial instruments.

Employee share purchase plans

We disagree with the fact that employee share purchase plans are within the scope of the proposed standard.

We consider that those plans do not constitute a retribution for services rendered or goods acquired, but a mere issuance of equity reserved to a specific population, namely the employees of the company. This issuance may involve a discount because, for specific reasons, it brings different advantages the company than those resulting from a regular call to the market. These reasons are : stability of employment, better control of shares issued to the public, utilisation of employee savings, etc…

Furthermore, there is no direct link between the opportunity offered to employees and their wages, or the services rendered.

Moreover, in most cases, there is very little difference, if any, between the actual conditions offered under an employee share purchase plan and the conditions of a regular market equity issuance. In France, the main reason why employees subscribe to these plans is the employer contribution (which can be up to 75% of the investment), already accounted for as an expense. Moreover, the discount part of the selling price should represent both the impossibility to sell the shares for 5 years.

Finally, the shares acquired through those plans are often managed in dedicated funds, and most of the time these funds do not hold only shares of the company. This means that the total amount of the wages of the company, as calculated by the discount granted on its own shares, will depend on the decision of a fund manager who is neither an employee nor part of the company. We do not understand the reasoning behind accounting for amounts so determined as wages/expenses.

The Basis for conclusions of the Exposure Draft recognises the specificity of employee share purchase plans, but refuses to address the issue on the ground that it is not possible to clearly identify what constitutes an employee share purchase plan, as opposed to stock option plans. We agree that a rule based approach, similar to the FASB's, would be complex to implement. If the IASB still considers this information necessary in the financial statements, we think it would be more appropriate to describe the main features of the employee share purchase plan in the note.

Modification of the terms and conditions of stock option plans

We consider that when a plan has been duly given up by the employees, and replaced by a new plan, the former plan should not lead to the accounting for expenses any more.

Accounting for vesting conditions

We consider that the accounting for vesting conditions involve two different issues, that need to be dealt with separately.

First of all, the existence of a vesting period results in the fact that, during a certain period, the granted options will be neither exercisable nor transferable. The joint effect of these two factors will have a strong impact on the pricing of the option which should lead to a discount on the prices that would arise from the application of standard valuation models;

Secondly, due to the vesting conditions, the number of options that is at first granted is not the number of options that will actually be given up by the company. We consider that the total expense should be based on the actual number of options given up, and, in that sense, favour an approach ("truing up") similar to FAS 123.

Definition of an expense

Paragraphs 78, 94 and 97 of the IASB Framework state that:
"…They [the expenses] usually take the form of depletion of assets…"
"…recognition of expenses occurs simultaneously with the recognition of an increase in liabilities or a decrease in assets…"
"…An expense is recognised immediately in the income statement when an expenditure produces no future economic benefits…"

Even though we have agreed that granting stock options to employees constitutes an expenditure, we think the definitions above are not consistent with this assumption, and we are not convinced with the arguments detailed in the Basis for conclusions (§46 - the gas example). We are concerned with potential interpretations and assimilation to future or other situations where an expense would be defined as such with regard to the definition applied to the share based payments.
Moreover the last quote above suggests that the expense, if any, should not be deferred along the vesting period, as services are consumed when stock options are granted.

Convergence

We note that there is a move in the U.S to account for share based transactions as an expense. However if IASB would issue a standard requiring such transactions to be accounted for as an expense, for comparability reasons we believe the FASB should treat these transactions in the same manner as the one recommended by the IASB. In case this would not be attained there is a danger to cause a competitive disadvantage for the companies applying IFRS.

If you would like further clarification on the points raised in this letter, I will be happy to discuss this further with you.

Yours sincerely,

Antoine BRACCHI

Question n°1 :

Paragraphs 1-3 of the Draft IFRS set out the proposed scope of the IFRS. There are no proposed exemptions, apart from transactions within the scope of another IFRS.

Is the proposed scope appropriate ? If not, which transactions should be excluded and why ?

We disagree with the fact that employee share purchase plans are within the scope of the proposed standard.

- We consider that those plans do not constitute a retribution for services rendered or goods acquired, but a mere issuance of equity reserved to a specific population, namely the employees of the company. This issuance may involve a discount because, for specific reasons it benefits more the company than a regular call to the market would. The collateral advantages of this specific equity issuance are : stability of employment, better control of shares issued to the public…..
- There is no direct link between the opportunity offered to employees and their wages. Thus, it is difficult to consider that the discount granted to the employees constitutes a remuneration for services rendered.
- Moreover, in most cases, there is very little difference, if any, between the actual conditions offered under an employee share purchase plan and the conditions of a regular market equity issuance.

The Basis for conclusions of the Exposure Draft recognizes the specificity of employee share purchase plans, but refuses to address the issue on the ground that it is not possible to clearly identify what constitutes an employee share purchase plan, as opposed to stock option plans. We agree that a rule-based approach, similar to the FASB's would be complex to implement because it could not correctly reflect the various economic and legal situations of the various countries where stock option plans are issued .Therefore, we definitely favor a principle based approach recognizing that such plans are outside the scope of the proposed IFRS.

Besides, we favor an approach describing in the notes the main features of an employee share purchase plan.

The following paragraphs give a detailed view of the rationale of our position. This rationale are considered from the point of view of the employees, and from the point of view of the company.

From the point of view of the company

It appears that in many cases, the actual discount provided to employees are small, and can be comparable to discounts granted in a regular call to the market. When the discount appears to be higher than the average market discount, it is considered that this discount offsets the binding conditions of the plan such as, for example, restrictions on the conditions of the transfer of the options.

As no expense is accounted for the discount granted on a regular market call, we do not see any reason to account for an expense in the case of employee share purchase plans.
Another consideration arises from the comparison with the case when the company purchases the shares which are sold back to the employees with a discount. According to other IAS standards, this loss would go against equity and not be dealt with as an expense.

From the point of view of the employee

According to representatives of companies' members in the working group, most employees do not consider the grant as part of their salaries. Moreover, those representatives expressed on the low subscription rate on employee share purchase plans. This could show, among other reasons, that the employees consider the risk linked to the binding conditions of the plans is higher than the discount offered by the company.
Also, the shares acquired through those plans are often managed in dedicated funds, and most of the time these funds do not hold only shares of the company. This means that the total amount of the wages of the company, as calculated by the discount granted on its own shares, will depend on the decision of a fund manager who is neither an employee nor part of the company. We do not understand the reasoning behind accounting for amounts so determined as wages/expenses.

Question n° 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?

We agree with paragraphs 4-6.

Question n° 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 instruments granted, whichever fair value is more readily determinable, whichever fair value is more readily determinable (paragraph 7). There are no exemptions to the requirements 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?

We disagree on the fact that it is always possible to evaluate reliably either the value of the service rendered, or the value of the equity instrument granted (please, see below for rationale). When it is not possible to reliably estimate the fair value of share based payment transactions we consider that an information in the notes to the accounts would be more advisable than an actual booking of the transaction.

We strongly question the conclusions of the Exposure Draft as to the measurement of share-based payment transactions, and notably the ones related to stock option plans because:

The proposed model does not correctly reflect the fair value of the services rendered

We have reservations when considering that the value of financial instruments granted in retribution to services by employees is a good measurement of the value of these services. Option prices are volatile by nature, as they amplify variations in the prices of underlying shares. Even for heavily traded instruments, it is very common to see overnight variations of over 30% of the price of short term option. In France there is no quoted and liquid market for options over 9 months, but we have no indication which would lead us to believe that the observation relating to short term option markets should be reconsidered, for long term options.

Consequently, what sense does it make to price a service at a value which could differ significantly according to the day referred to ? This should be taken into account when evaluating the comparability of the accounts between one company and another.

With regard to the IASB Framework (§ 86 and 31 to 38) we wonder whether an expense that would be subject to such variations of measurement should be considered as a reliable measurement or estimate.

The proposed model needs to be adapted by each user

The only valuation models that are referred to in the ED are the Black and Scholes and Binomial models.

Because these two models are not precise enough and are suited only for traded and liquid equity instruments, market operators use internally developed models to evaluate options on non traded equity instruments. Basically, what these models do is mitigate the results of standard models, such as Binomial or Black and Scholes, by taking into account the impact of the lack of liquidity.

According to the experts of our working group, it leads to significant discrepancies among the derived methods. In other words they believe three different experts would come up with three different valuations for the cost of the same option plan although, these experts noted that for listed companies with high volumes of transactions, adaptations of the models lead to estimates within close ranges, although these options remain not negotiable.

Finally, contrary to common practice when using Black and Scholes, back testing to verify the effectiveness of retained parameters is impossible because these options are not negotiable. This leads to specific and strong concerns for the reliability of the valuation of options on non liquid shares.

The proposed model is not suitable for non-liquid markets

One of the main hypotheses for both models is that there is a liquid market, both for the option and the underlying equity instrument. It does not appear that any academic model exists that provides valuation for options on non traded or non liquid instruments.

The proposed model only gives ranges of values

Finally, these internally developed models do not come up with a definite price for the option, but with a range of estimates. IAS 39 (§69 and 101) acknowledges the fact that there are "equity instruments that do not have quoted price in an active market, and whose fair value cannot be reliably measured". It appears that many of the instruments granted in stock option plans are part of the financial instruments related to the category set by paragraph 101 of IAS 39.

Overall, we consider that the difficulties arising from the measurement of share based transactions are central to the project.

- The main goal of the project is to give an accurate view of the expenses of a company. This would lead to quite a unique standard among the other IASB standards, as it deals with the definition of an expense with no change in the net assets of a company. Yet, expenses are generally considered as a result of a variation of assets or liabilities. In this context, due to the uncertainties surrounding the measurement of the expense for options on shares in illiquid markets, it is questionable if comparability and accuracy of the income statement could be reached when expenses are measured with different methods from one company to the other.
- We therefore consider that, when stock options relate to a quoted and liquid market (or in more general terms, when they are reliably measurable) the value so determined should be accounted for in the income statement. On the contrary, when no reliable value of the option granted can be determined, a clear information in the notes to the financial statements on the nature, the number of the options granted, the range of cost, …etc would be more advisable than an actual recognition of the transaction.

Question n°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 equity instruments granted? If not, at which date should the fair value of the goods or services granted be measured? Why?

We agree.

It was decided to agree with the Exposure Draft on the following grounds :

- it seems natural to recognize goods or services at the date at which they are really acquired or consumed by the company,

- still, some services are extremely difficult to evaluate per se (wages). This is why the standard proposes to evaluate them through the measurement of options or other equity instruments. In this case, the evaluation of services is based on the conventional value of the contract between the company and its employees. This conventional value is equal to the agreed contractual value when the option is granted. It would not be justified to refer to the value of the options when the service is actually rendered.

Therefore we agree with the proposed standard, although it might seem odd to come up with two different dates for the valuation of share based payment transactions.
In any case, we believe the point to be of little consequences.

Question n°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 instruments granted? If not, at which date should the fair value of the instrument granted be measured? Why?

We agree with the proposed standard. Please, see above for the rationale.

Question n°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?

It seems appropriate to consider that the fair value of the goods or services received is more readily determinable than the fair value of the equity instruments granted, when a company acquires goods or services that are traded on an active market.

- However, the presumption should be reversed when there is no market for the goods or services acquired, on which prices for the goods or services acquired could be easily and reliably obtained.

- This absence of an active market is common for many of the services settled through share based payments.Most of the services acquired through share based payments appear to be very specific, and are hardly comparable from one situation to the other (success fees……). Therefore, because of the absence of transactions that could be considered comparable, in many cases, it cannot be considered that there is an active market for the transactions.

Question n°7 :

For equity-settled transactions with employees, the draft standard 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 ?

We agree. Still, we consider that the use of the fair value of the equity instruments granted could only be made a rebuttable presumption.
It was considered that :

- some options on non liquid instruments are hard to evaluate (please see below),

- there is an active market for some standard job positions, with reference market prices,

- therefore, in some rare cases, the value of personnel services could be more reliably apprehended through the valuation of the services, than through the evaluation of the equity instruments granted.

Question n°8 :

Paragraphs 13 and 14 of the draft IFRS proposes requirements for determining when the counterpart renders service for the equity instruments granted, based on whether the counterpart 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 service rendered by the counterpart as consideration for the equity instruments are received during the vesting period? If not, when are the services received, in your view?

We agree, unless it is clear that the options were granted for services which have already been rendered in the past.

Question n°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 , 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?

We disagree.

- First of all, we do not consider that the word "surrogate measure" is appropriate to qualify the way of measuring the fair value of the services obtained as a counterpart for the options granted. The options granted – and then vested - constitute what is actually given to the employees, as a retribution for their work. They are the real cost of the services, in the sense they represent the value of the services on which the two parties agree upon. If the value of the options were accurately measurable that would be the right figure to book in the income statement. As sometimes they are not, there is a choice between the two following measurements :

  - the fair value of the financial instruments granted,

  - or the value of the services per se.

- Regarding the measurement of the options, we would favor an approach similar to the one of FAS 123, where the adjustment arising from the forecast forfeiture level is not made through the fair value of the options granted, but through the calculation of the global amount of the expense calculated over the period. This forecasted global amount should be revised each year, according to the reality of the forfeiture level.

- Example

A grant of 10 share options, vesting after 3 years of service to 10 employees (so 100 options in total)
Fair value option at grant date € 12

Entity expects that 2 people will leave at the middle of the vesting period

Ultimately, 50 % of the options do not vest due to unusual high turnover of employees : 5 people leave at the middle of year three.

The expense recognition should be as follows :

Expense :	**Cumulative**	**Annual**
Year 1	(80 x € 12) x 1/3 = € 320	€ 320
Year 2	(80 x € 12) x 2/3 = € 640	€ 320
Year 3	(50 x € 12) x 3/3 = € 600	(€ 40)
	Total :	€ 600

Please, refer to question n°10 for a more accurate description of the reason who favor an approach similar to FAS 123.

Question n°10:

In an equity settled share-based payment transaction, the Draft IFRS proposes that having recognized the services received and a corresponding increase in equity, the entity should make no subsequent adjustment to total equity, even if the equity instrument 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 recognizing a transfer within entity, ie a transfer from one component to another.

Do you agree with the proposed requirement ? If not, in what circumstances should an amendment be made to total equity and why ?

There are two issues in the above question which we are addressing separately hereinafter.

As stated in our answer to question 9, we consider that «share based payments » granted to employees correspond to wages in return for services rendered, or to be rendered. The total value of the service rendered is determined at the day of the grant, and is based on the value at that date of the options granted. . In our view, the total amount of the expense should be calculated by taking into account the actual number of shares that will be granted. This number will only be known at the vesting date.

This being said , two issues are :

- 1 – Should the variations of the price of the option after the grant date be taken into account?– a subsequent question to this being : what happens if the options are not exercised, because of a fall in the price of the underlying share ?
- 2 – How do we account for the options granted that do not vest ?

- 1) Should the variations of the price of the option after the grant date be taken into account?

We consider that, as soon as the options have been granted, the holder of the option acts as a stockholder : any loss or gain he may incur due to the variations of the share price does not correspond to a remuneration of the service, but to capital gains or losses (for the employee not the company), and therefore, should not be included in the expenses (wages) of the company.

However, a few members of the CNC working group consider that the vesting date is actually the date when the value of the expense should be calculated. Their main rationale is that what will actually be given by the company is equivalent to the price of the option at the vesting date.

Still, it was the view of the CNC to consider that the differences that arise from variations in the price of the options correspond to variation on own equity, which IFRSs do not account for .

As soon as a share based payment is made (grant date or vesting date), a company finds itself in the place of an option issuer. As the option is on one's own equity, IFRSs consider that no loss or gain can be accounted for on the option.

- 2 – What happen if some options do not vest ?
-

We consider that the total expense of the company should be equal to what it will actually give away – that is to say the fair value of an option, as calculated at the grant date, multiplied by the number of options that will actually be given away. We do not consider it would be appropriate that the total expense be different from what is actually given. If a company receives more units of services than it gives away options, we consider that the price actually paid by the company should be booked, not the calculated value of the services received. This case is equivalent to a debt for services rendered that would never be paid off. The way to obtain an accurate expense by truing up the amount of options granted is detailed in our answer to question 9. In addition to our answer to question 9, we have a different approach than the one of FAS 123, on the fact that we consider that revisions of estimates can only result in the reduction of expenses of the next period, never to generation of profit. Due to this limit, our proposed mechanism, also recommending truing up, never leads to changes in equity

Question n°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 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 the option granted? If not, by what other means should be 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 cannot agree for, in some instances, the existing valuation models might not be able to accurately estimate the fair value of options granted. This is particularly true of options of non traded companies or newly introduced companies.

As it is stated in the exposure draft, some factors are compulsory to make the various existing models work. These factors are stated in paragraph 21. In the case of non traded or newly introduced companies there is by definition, notably, no data on the volatility of the shares. Paragraph 139 of the Basis for Conclusions proposes that in the absence of information on the volatility of the underlying share, data of a company with similar characteristics be used.

With regard to the IASB Framework (§ 86 and 31 to 38) we wonder whether this should be considered as a reliable measurement or estimate and therefore have concerns that expenses evaluated through such methods do not have enough accuracy to be booked and be part of the P and L.

In fact, the only valuation models that are referred to in the ED are the Black and Scholes and Binomial models.
In the case these two models are not precise enough to deal with the specific characteristics of an option, market operators use internally developed models to evaluate options on non traded equity instruments. Basically, what these models do is to mitigate the results of standard models by taking the impact of the lack of liquidity or other factors into account.

According to the experts of our working group, it leads to significant discrepancies among the derived methods. In other words they believe three different experts would come up with three different valuations for the cost of the same option plan.

Besides, the proposed model only gives ranges of values.

Finally, these internally developed models do not come up with a definite price for the option, but with a range of estimates. IAS 39 (§69 and 101) acknowledges the fact that there are "equity instruments that have no quoted price in an active market, and whose fair value cannot be fairly estimated". It appears that many of the instruments granted in stock option plans are part of the financial instruments related to the category set by paragraph 101 of IAS 39.

Overall, we consider that the difficulties arising from the measurement of share based transactions are central to the project.

The main goal of the project is to give an accurate view of the expenses of a company. This would lead to a unique standard among the other IASB standards, as it deals with the definition of an expense with no change in the net assets of a company. Yet, expenses are generally considered as a result of a variation of assets or liabilities. In this context, due to the uncertainties surrounding the measurement of the expense, it is questionable if comparability and accuracy of the income statement could be reached when expenses are measured with different methods from one company to the other.

We therefore consider that, unless stock options relate to a quoted and liquid market (or in more general terms, when they are reliably measurable), a clear information in the notes to the financial statements on the nature and number of the options granted would be more advisable than an actual recognition of the transaction. Though the downside of this option would be comparability among companies.

Question n° 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 do not think that the joint effects of the fact that the option is both non transferable and non exercisable has been fully dealt with by the proposed draft. As stated in the Draft BC 161 "If the option cannot be transferred and cannot be exercised, and assuming that other derivatives are not available, the holder is unable to extract any value from the option or protect its value during the vesting period". We consider that this inability has a strong effect on the value of the option, that is not correctly grasped by modifying the exercise date of the option.

In order to justify why the consequences of the joint non transferability and non exercisability are not addressed, paragraph BC 162 states that the employee has not started to work when the option is at first granted. According to § BC 162, this neutralises the joint impact ; we disagree. We consider that employees are rewarded for their work during N years by the grant of an option the valuation of which is to be determined at grant date. The fact that he has not started to work yet has no impact on the valuation of the option granted.

Moreover, paragraph BC 164 considers that the valuation of the option is only to be considered from the "enterprise perspective". We do not understand this point which we think should be reconsidered. A market price is the price upon which two knowledgeable parties would agree. We do not understand what a market price is from one party's perspective only.
In conclusion, we consider that the joint effect of the fact that the option is non transferable and non exercisable has been not sufficiently dealt with. We propose that the amounts arising from the application of standard models be discounted, to take into account this double effect. Conceptually, this discount aims at compensating the inability of the holder to extract any value from the option for a certain amount of time. It is different from the fact that the total expense will depend on the fact that some options will not vest, which, in our opinion, should be taken into account via truing up.

Question n°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 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 ?

We favour a mixed approach : we consider that the number of shares that actually vest should be submitted to a truing up similar to the one of FAS 123, that is to say via the valuation of the number of options that will actually be granted (see question 9). The fact that the holder of the option will not be able to take advantage of the option for a given time should be taken into account when estimating the fair value of the options granted.

Question n°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 ?

We agree

Question n°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 conditions (paragraphs 21-25).

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

Besides the comments we made on question 12, we wonder whether the effects of the absence of liquidity, both on the option and the underlying share, have sufficiently been taken into account. Both models (Black and Scholes and binomial) are founded upon the fact that both the option and the underlying share are traded on totally liquid markets. This is not the case for most of the stock options granted under stock option plans and we wonder whether this fact has not been underestimated by the Draft.

Question n°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 ?

We do not consider that all measurement issues related to share based payments have been sufficiently and accurately taken into account either by the guidance of this Draft, or by academic valuation models. Therefore, we question the possibility of always coming up with accurate valuations of share based payment (please, refer to our answers to other questions, and our general comments).

Question n°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, 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?

To make things easier, we would favour an approach easier to implement. We consider that no difference is to be made between a modification to terms or conditions of a plan, or the cancellation of an existing plan. In both cases, we consider that the cancellation or the modification arises because the plans that were first offered to the employees do not correspond to market conditions any more. Therefore, the plan that once existed has been replaced by a new one more up to date with market conditions. Because the initial plan does not exist any more, and the rights of the employees have been duly given up, we consider that no more expenses are to be accounted for due to the former plan. The replacement plan is accounted for as any new plan. In the case , cash is granted to employees as a compensation for the change from the old plan to the new one, we do agree with the proposed requirements of the Draft IFRS (see §29 (b) of the Draft IFRS)..

Question n°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.

Please, refer to question n°17.

Question n°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.

We consider the proposed requirements appropriate.

Question n° 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.

We consider the proposed requirements appropriate.

Question n° 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)?

In some cases (please refer to our other answers), we consider that it is inappropriate that the fair value of the options given be booked in the income statement, as no reliable measurement exists. Moreover the existing models available to estimate the fair value of the options are not able to come up with a definite value but only give a range of estimates. In this case, we recommend in our other answers, that no booking be made but an information in the notes to the accounts of the range of estimates, and the methods that were used to come up with this range.

Question n°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 (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).

We agree with the proposed requirements.

Are the proposed requirements appropriate ? If not, please provide details of your suggestions for the IFRS's transitional provisions.

We agree with the proposed treatment..

Question n°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 agree with the requirements.

Question n°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.

(Respondents may wish to note that further details of the differences between

the draft IFRS and SFAS 123 are given in the FASB's Invitation to Comment.)

(a)
- employee share purchase plans : we agree with the FAS 123 and disagree with the proposed IFRS. Still, as opposed to FAS 123, we consider that the way to apprehend the criteria that define an employee share purchase plan should be principle-based (absence of vesting conditions, issuance of equity instruments with prices similar to regular market prices, taking into account the various restrictions imposed on the instruments issued), not rule-based. Please, refer to the answer to question n°1.

(b)

- We favour an approach globally similar to FAS 123. Please, refer to questions 9 and 10 for detail.

(c)

- We prefer an accounting treatment that is neither the one of the FAS nor the one proposed by the Draft. Please, refer to question 17

(d)

- We agree with the proposed IFRS.

(e)

- We agree with the draft IFRS

(f)

- We agree with the draft IFRS

Question n° 25 :

Do you have any other comments on the Exposure Draft?