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The South African Institute of Chartered Accountants
Die Suid-Afrikaanse Instituut van Geoktrooieerde Rekenmeesters

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Dear Kimberley

EXPOSURE DRAFT 2 ON SHARE-BASED PAYMENT

In response to your request for comments on the exposure draft on share-based payment, I attach the comment letter prepared by the South African Institute of Chartered Accountants (SAICA). Please note that SAICA is not just a professional body, but also secretariat for the Accounting Practices Board (APB), who is the official standard setting body in South Africa.

We would like to thank you for the opportunity to provide comments on this document. We have, in addition to our response to the questions raised, also included general comments on aspects not specifically dealt with in the questions. We commend the efforts of the International Accounting Standards Board (IASB) in dealing with this topic, which over the years has evoked emotions, particularly in relation to accounting for share options. In addition, with this being an area of accounting for which there is little internationally accepted guidance, the efforts of the IASB in producing a standard based on international consensus is supported.

Please do not hesitate to contact me should you wish to discuss any of our comments.

Yours sincerely

Sue Ludolph
Project Director - Technical

cc: Peter Wilmot (Chairman of the Accounting Practices Board)
Pat Smit (Chairman of the Accounting Practices Committee)

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GENERAL COMMENTS

Broad principles

Our comments have been based on the following broad principles which we highlight below:

Recognition as an expense

We agree with the Board's objective of requiring recognition of share-based payments as an expense at fair value in the grantor's income statement. We believe that this principle can be broadly applied to all share-based payment arrangements.

Measurement date

Although recognising weaknesses in the fair value at grant date model, we concur with the Board's conclusion that this approach represents the best balance of alternative dates and most closely reflects the intentions of the contracting parties. This measurement date will, as the Board notes, often require measurement based on the estimated value of the consideration. The assumption that the value of the goods or services and the consideration are equal is most appropriately made at the grant date. However, we consider it to be very important for the Board to identify and articulate clearly for both preparers and users of financial statements the judgements, assumptions, conventions and potential anomalies the grant date measurement model introduces.

After considering the alternatives weighed up by the Board, on balance we support the approach proposed in ED 2 to require grant-date measurement of the estimated fair value of payment offered for employee services and to expense this payment over the vesting period.

Measurement – direct vs indirect method

In our view the entity should measure the share-based transaction at fair value, based on the fair value of the financial instrument issued. In practice this can be done either by directly measuring the fair value of the equity instrument issued or indirectly by measuring the fair value of the goods or services received. While ED 2 proposes to use whichever measure is more readily determinable, we believe that the principle should be to use whichever measure is more **reliable**. Using the phrase "readily determinable" appears to require the use of the "easiest" fair value to determine. We note that **reliability** is a cornerstone in the IASB Framework, and should therefore be the measurement basis.

Repricing and cancellation of options

If options are repriced or cancelled, the accounting for those options should be discontinued at that point, and the repriced options or new options should be separately accounted for from the date that they are granted.

Other issues

We would like to bring certain controversial issues to the Board's attention:

- The use of grant date measurement involves a significant degree of judgement and estimation.

  It is important for the final standard to acknowledge that fair value is an estimate subject to significant variability based on a valid range of possible assumptions. The valuation model that the Board proposes in ED 2 is an inter-dependent package of assumptions and conventions that requires a significant degree of judgement, especially when the measurement of goods or services is made indirectly by estimating the fair value of the share-based payment. Application of this model will require estimation of a number of variables, which means that the measurement of similar transactions may vary considerably from entity to entity, based on differences in judgements about future performance of both the entity and of the individual being compensated. However, it is acknowledged that "similar" transactions across entities are unlikely to exist since each entity will have peculiarities to its share-based incentive schemes and the individuals offering services across entities are seldom easily comparable. The model also results in original estimates not being adjusted to reflect actual outcomes, especially for transactions where share-based payments are "all or nothing" rather than vesting on a pro rata basis. This may appear counter-intuitive to some.

- Grant date measurement without subsequent "truing up" of assumptions means that the cost recognised for cash and share-based payment for the same services may differ. As an illustration consider a multinational with key employees in differing jurisdictions. For tax or legal reasons, the key employees in some countries are given share options and in other countries equivalent employees are given cash settled share appreciation rights on identical terms. The share options would be measured at grant date and not adjusted for forfeiture or increases in value. In contrast, the liability for share appreciation rights would be adjusted until they vest, for both forfeiture and changes in value of the shares. Therefore ED 2 does not eliminate all differences between cash and equity-settled transactions.

  For this reason we would support the "truing up" of share options when they are exercised even though this may create an exception to the principle of equity not being adjusted after being initially recorded. This would also overcome the issues relating to the subjective value of options, noted above.

SPECIFIC COMMENTS ON QUESTIONS RAISED

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?

It is essential that there is a clear distinction between the scope of the share-based payment standard and the financial instrument standards. IAS 32 and IAS 39 contain definitions of financial liabilities and equity instruments. In addition these standards provide guidance as to the distinction between these categories of financial instruments. In the revisions to the standards changes are proposed to these definitions and guidance. Under the proposals in ED 2, equity-settled share-based payment transactions are treated, in the main, as equity instruments of the issuer. This treatment may not be consistent with the treatment that would have resulted had the financial instrument standards been applied.

It is our understanding that this standard would not be applicable to transactions whereby goods or services are purchased for a fixed cash amount, with an option for the supplier to take up shares instead. We assume that such a transaction would be accounted for as a compound instrument in terms of IAS 32/39. In our view it is worth clarifying this point.

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?

We agree that, consistent with other standards, transactions involving goods should be recognised when the risks and rewards of ownership pass. We also agree that, for transactions involving services, an expense should be recognised over the period of service, or where no period is specified, over the period that the service is expected to be received.

Question 3

For an equity-settled share-based payment transaction, the draft IFRS proposes that, in principle, the entity should measure the goods or services received, and the corresponding increase in equity, either directly, at the fair value of the goods or services received, or indirectly, by reference to the fair value of the equity instruments granted, whichever fair value is more readily determinable (paragraph 7). There are no *exemptions to the requirement to measure share-based payment transactions at fair value. For example, there are no exemptions for unlisted entities.*

Is this measurement principle appropriate? If not, why not, or in which circumstances is it not appropriate?

As noted under General Comments, the entity should measure the share-based transaction at fair value based on the fair value of the financial instrument issued. In practice this can be done either by directly measuring the fair value of the equity instrument issued or indirectly, by measuring the fair value of the goods or services received. While ED 2 proposes to use whichever measure is more readily determinable we believe that the principle should be to use whichever measure is more **reliable**. Using the phrase "readily determinable" appears to require the use of the "easiest" fair value to determine. We note that **reliability** is a cornerstone in the IASB Framework, and should therefore be the measurement basis.

We generally agree that there should be no exceptions to the fair value principle. However, we observe that there could be circumstances where it may be difficult to obtain the necessary information to estimate the fair value of share options in unlisted entities. We encourage the Board to develop additional guidance for determining fair value for these entities. Although we understand the comments made in the Basis for Conclusions, we believe that, for unlisted entities, the minimum value approach would be an acceptable compromise.

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?

In general the measurement principle is that the share-based payment transaction should be measured at the date that both parties are contractually committed to the transaction, regardless of when the services are provided. This is the date a financial instrument comes into existence. The final standard should be clarified to include further guidance for determining the measurement date of a transaction in which services are delivered over an extended period of time. This should occur when the counterparty is contractually committed to providing the service. In the absence of a contractual commitment to perform, the value should be measured at the point at which substantive services by the counterparty commence.

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?

Subject to our concerns noted under General Comments about grant date, we agree that the appropriate date at which to measure the fair value of the equity instrument granted is the grant date.

As discussed in our response to Question 4, our view is that the appropriate measurement date is when both parties are contractually committed to the transaction. If the two parties to the arrangement have negotiated a committed contract under which both parties are committed to perform, grant date measurement is appropriate. In our view the notion of a firm commitment would be consistent with IAS 39.

Question 6

For equity-settled transactions with parties other than employees, the draft IFRS proposes a rebuttable presumption that the fair value of the goods or services received is more readily determinable than the fair value of the equity instruments granted (paragraphs 9 and 10).

Do you agree that the fair value of the goods or services received is usually more readily determinable than the fair value of the equity instruments granted? In what circumstances is this not so?

We do not support the Board's decision to establish a rebuttable presumption that certain transactions should be valued by reference to the fair value of the goods or services received, while other transactions should be valued by reference to the fair value of equity instruments granted. The general principle should be that the fair value of the transaction is determined by valuing whichever side of the transaction can be more reliably measured. Also refer to our General Comments. Having said the above, we acknowledge that determining the fair value of goods or services from third parties may be more reliably determinable than valuing services received from employees.

Conceptually, we agree that certain transactions with non-employee service providers may be economically identical to transactions with employees. As a result, there should not be a presumption based on whether the transaction involves an employee or non-employee. It should be acknowledged however, that an employee can seldom be considered to be a truly independent arms-length contracting party.

Question 7

For equity-settled transactions with employees, the draft IFRS proposes that the entity should measure the fair value of the employee services received by reference to the fair value of the equity instruments granted, because the latter fair value is more readily determinable (paragraphs 11 and 12).

Do you agree that the fair value of the equity instruments granted is more readily determinable than the fair value of the employee services received? Are there any circumstances in which this is not so?

As indicated in our response to Question 6, we do not agree that there should be a rebuttable presumption that certain transactions be valued by reference to the fair value of the goods or services received, while other transactions should be valued by reference to the fair value of equity instruments granted.

As also indicated in that response, a distinction should not be made between transactions with employees and parties other than employees. It is debatable why there should be a difference in the proposed treatment of the two categories of transactions, given that the method of payment merely reflects the value of the goods or services received (from an outside party or an employee). We recommend that the fair value of the equity instrument should be used as the benchmark treatment for determining the value of transactions with employees and outside parties.

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?

If benefits only vest when the counter party has completed a specified period of service, the services should be presumed to be provided over that vesting period.

Question 9

If the services received are measured by using the fair value of the equity instruments granted as a surrogate measure, the draft IFRS proposes that the entity should determine the amount to attribute to each unit of service received, by dividing the fair value of the equity instruments granted by the number of units of service expected to be received during the vesting period (paragraph 15).

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

If the value of services to be provided by employees is only based on the value of options at grant date, our view is that it is appropriate to attribute that value to each unit of service expected to be received. Following on from this, it is logical to calculate the value of 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.

In our view the unit of service method should be principles-based rather than rules-based. The existing method could be retained as an illustrative example of one method, but entities should be permitted to use other methods, for example one that takes into account other measures of service, such as units delivered, provided that reflects more fairly the services rendered.

Question 10

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

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

The entity should not make adjustments to total equity if equity instruments do not vest, or share options are not exercised. This view is based on equity being regarded as a residual.

Question 11

The draft IFRS proposes that the entity should measure the fair value of equity instruments granted, based on market prices if available, taking into account the terms and conditions of the grant (paragraph 17). In the absence of a market price, the draft IFRS proposes that the entity should estimate the fair value of options granted, by applying an option pricing model that takes into account various factors, namely the exercise price of the option, the life of the option, the current price of the underlying *shares, the expected volatility of the share price, the dividends expected on the shares (where appropriate) and the risk-free interest rate for the life of the option (paragraph 20). Paragraph 23 of the proposed IFRS explains when it is appropriate to take into account expected dividends.*

Do you agree that an option pricing model should be applied to estimate the fair value of options granted? If not, by what other means should the fair value of the options be estimated? Are there circumstances in which it would be inappropriate or impracticable to take into account any of the factors listed above in applying an option pricing model?

The valuation approach required by the draft IFRS should be consistent with the IASB's fair value hierarchy. In particular, the fair value of the option should take account of all the terms and conditions of the grant. In the event the option is traded in a market, the market price should be used. In the event that market data for similar transactions are not available, we concur that an option-pricing model should be applied to estimate the fair value of options granted.

We support using option pricing models to determine the fair value of options granted and not prescribing the models to be used. However, we are concerned that it will be difficult in practice to determine appropriate inputs and adjustments to an option-pricing model, particularly where market data is not available. We strongly recommend that the IASB performs field-tests of the proposals in order to assess whether the proposed approach is likely to result in reliable measurements in practice, before issuing a final standard.

We refer to our comment made for Question 3, that for unlisted entities the minimum value approach would provide a sufficiently reliable measure for such entities.

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?

Arguments can be made both for and against replacing an option's contracted life with expected life when adjusting the option's fair value for the effects of non-transferability. However, we would support the approach adopted in the exposure draft. This would seem to be similar to taking into account the expected service period to be provided by employees in determining the value of each unit of service received.

Question 13

If a grant of shares or options is conditional upon satisfying specified vesting conditions, the draft IFRS proposes that these conditions should be taken into account when an entity measures the fair value of the shares or options granted. In the case of options, vesting conditions should be taken into account either by incorporating them into the application of an option pricing model or by making an appropriate adjustment to the value produced by such a model (paragraph 24).

Do you agree that vesting conditions should be taken into account when estimating the fair value of options or shares granted? If not, why not? Do you have any suggestions for how vesting conditions should be taken into account when estimating the fair value of shares or options granted?

We agree that vesting conditions should be taken into account when estimating the fair value of options or shares granted.

Question 14

For options with a reload feature, the draft IFRS proposes that the reload feature should be taken into account, where practicable, when an entity measures the fair value of the options granted. However, if the reload feature is not taken into account in the measurement of the fair value of the options granted, then the reload option granted should be accounted for as a new option grant (paragraph 25).

Is this proposed requirement appropriate? If not, why not? Do you have an alternative proposal for dealing with options with reload features?

A reload feature should be factored into the fair value of an option granted if its fair value can be reliably determined. However, this may be difficult and we therefore request the Board's additional guidance with respect to the method that entities should use to value the reload feature of an option grant.

Question 15

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

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

It appears that paragraph 21 to 25 contain the most common features of employee share options.

Question 16

The draft IFRS does not contain prescriptive guidance on the estimation of the fair value of options, consistently with the Board's objective of setting principles-based standards and to allow for future developments in valuation methodologies.

Do you agree with this approach? Are there specific aspects of valuing options for which such guidance should be given?

The IFRS should be requiring companies to utilise the most appropriate pricing model and therefore it should not specify which model to use, particularly as the IFRS itself might lead to the development of additional or more appropriate pricing models.

Question 17

If an entity reprices a share option, or otherwise modifies the terms or conditions on which equity instruments were granted, the draft IFRS proposes that the entity should measure the incremental value granted upon repricing, and include that incremental value when measuring the services received. This means that the entity is required to recognise additional amounts for services received during the remainder of the vesting period, i.e. additional to the amounts recognised in respect of the original option grant. Example 3 in Appendix B illustrates this requirement. As shown in that example, the incremental value granted on repricing is treated as a new option grant, in addition to the original option grant. An alternative approach is also illustrated, whereby the two grants are averaged and spread over the remainder of the vesting period.

Do you agree that the incremental value granted should be taken into account when measuring the services received, resulting in the recognition of additional amounts in the remainder of the vesting period? If not, how do you suggest repricing should be dealt with? Of the two methods illustrated in Example 3, which is more appropriate? Why?

If an entity reprices a share option, the accounting for the previous share option should discontinue and the repricing should be accounted for as a new share option. This is based on the premise that the repricing is reflecting that the value of the options has dropped to such an extent that the value of the services provided by the employee is no more than that for which other remuneration is received.

Furthermore, in using the value of the equity instrument at the grant date as a surrogate to determine the value of the proposed service from an employee, the total value of the service is effectively determined at this date – the allocation of the cost is based on the unit service method over the period of service and/or vesting period of the instrument.

Following on the base argument, allocating additional incremental cost associated with re-pricing indicates that the entity expects to receive additional service not originally expected, hence the additional incremental value. However, in reality this is not the case.

In practice, re-pricing an option or other equity instrument will only occur where the potential value associated with such an instrument has diminished significantly below the original expected levels, i.e. the objective of the re-pricing is to put the employee back in a similar position as at the original grant date.

Is seems illogical that the repricing per sè is indicative or will result in additional service to and cost for the entity. It is thus recommended that re-pricing or other modifications of the terms of an equity instrument or an option should be viewed on the same basis as a change in estimate.

The practical implication is that on modification, the original service recognition should be discontinued, and prospectively the expected future service cost should be estimated using the unit measurement basis, based on the remaining service period and the modified value of the instrument granted.

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.

As indicated in our response to Question 17, when an entity cancels a share option, accounting for the options should discontinue and the entity should separately account for whatever benefits or options are given to employees as a result of the cancellation.

The continued allocation and recognition of costs after cancellation of a share or option grant complies with the basic tenet of the proposed standard, that is, the service is recognised, and not the instrument issued or liability incurred. However, this leads to an illogical answer in this instance.

If the main argument holds true that an entity receives (additional) service in return for the equity instrument issued or granted (and therefore the additional compensation is in respect of future and not past service), the logical conclusion is that those services will no longer be received where the incentive/payment to the service provider is cancelled.

The illogical nature of the treatment is further illustrated where the entity does not specifically identify a new option grant as a replacement grant, as the new grant is then expensed in full (and not only on an incremental basis) over the applicable service period.

Therefore, in both these scenarios, the implied logic is that the entity will receive either incrementally more service from an employee (in a replacement scenario) or totally new and additional service not previously expected in respect of the "new" grant scenario.

The example on page 52 of the draft standard illustrates this point. Using the prescribed method, the implication is that the entity will receive additional service with a value of CU 328 000 during periods 3 and 4 in respect of the new grant of equity instruments. All other things being equal, this appears to be an incorrect representation of the reality. Employees will merely continue to provide the services for which the original options were granted. The cancellation and new option grant restores the status quo of the envisaged levels and cost of service (or amended cost of service) CU 328 000 of "new" service has not been created.

Furthermore, the additional expected service for which the equity instrument was originally issued or granted will not be received where the "compensation" is removed or not provided in the first place.

Question 19

For cash-settled share-based payment transactions, the draft IFRS proposes that the entity should measure the goods or services acquired and the liability incurred at the fair value of the liability. Until the liability is settled, the entity should remeasure the fair value of the liability at each reporting date, with any changes in value recognised in the income statement.

Are the proposed requirements appropriate? If not, please provide details of your suggested alternative approach.

As discussed in our response to Question 3, we support the principle that share-based payment transactions should be measured at the fair value of the financial instrument issued. Consequently we support ED 2's proposals in respect of cash-settled share-based payment transactions.

However, no guidance is given as to how the adjustments to the liability referred to in paragraph 34 should be shown in the income statement. They could either be presented with other fair value adjustments or be classified in the same manner as the underlying transaction that resulted in the liability. Our preference would be the latter, i.e. if the liability is incurred in the purchase of inventories, the adjustment to fair value should also be shown in cost of inventories.

Question 20

For share-based payment transactions in which either the entity or the supplier of goods or services may choose whether the entity settles the transaction in cash or by issuing equity instruments, the draft IFRS proposes that the entity should account for the transaction, or the components of that transaction, as a cash-settled share-based payment transaction if the entity has incurred a liability to settle in cash, or as an equity-settled share-based payment transaction if no such liability has been incurred. The draft IFRS proposes various requirements to apply this principle.

Are the proposed requirements appropriate? If not, please provide details of your suggested alternative approach.

We support the proposed requirements for share-based transactions in which the company or other party has the choice to receive cash or equity. However, the requirements for presentation of equity-based awards as liabilities or equity should be consistent with the liability and equity guidance in IAS 32 and IAS 39.

Question 21

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

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

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

The disclosures proposed in the exposure draft are too detailed. Although we appreciate the Board's desire to require disclosures that help users of financial statements to understand this complex area of accounting, the level of required disclosures should depend on the relative materiality of the amounts recognised in the financial statements and the option-pricing model selected (similar to that in IAS 36). In addition, we note that the level of disclosure detail proposed in this exposure draft is far greater than the level of detail required in IAS 19 (which deals with similar accounting issues).

Furthermore, paragraph 46 (b) refers to disclosure of the weighted average exercise price of options outstanding, inter alia, at the end of the period. Paragraph 46 (d) then requires additional disclosure in respect of options outstanding at the end of the period, including the range of exercise prices applicable. It is not clear what the necessity for both these disclosures are. We therefore believe that the disclosure should be simplified to only show the range of exercise prices for the various categories of options referred to in paragraph 46 (b).

Question 22

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

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

We would support a requirement that the IFRS be applied retrospectively for all share options that had not vested in order to achieve comparability. However, this may not be practical.

We also support the proposed transitional requirements in the exposure draft, but we recommend that disclosures should show the full extent of share options, distinguishing between those that have vested and those that have not vested, as well as those which have been accounted for in terms of the IFRS and those which have not.

In our view further clarification is needed in respect of the transitional provisions relating to cash-settled share-based payment liabilities existing on the effective date of the statement.

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 consequential amendment to IAS12.

Question 24

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

(a) Apart from transactions within the scope of another IFRS, the draft IFRS does not propose any exemptions, either from the requirement to apply the IFRS or from the requirement to measure share-based payment transactions at fair value. SFAS 123 contains the following exemptions, none of which are included in the draft IFRS:

- *employee share purchase plans are excluded from SFAS 123, provided specified criteria are met, such as the discount given to employees is relatively small;*
- *SFAS 123 encourages, but does not require, entities to apply its fair value measurement method to recognise transactions with employees; entities are permitted to apply instead the intrinsic value measurement method in Accounting Principles Board Opinion No. 25 Accounting for Stock Issued to Employees (paragraphs BC70-BC74 in the Basis for Conclusions give an explanation of intrinsic value); and*
- *unlisted (non-public) entities are permitted to apply the minimum value method when estimating the value of share options, which excludes from the valuation the effects of expected share price volatility (paragraphs BC75-BC78 in the Basis for Conclusions give an explanation of minimum value).*

(b) For transactions in which equity instruments are granted to employees, both SFAS 123 and the draft IFRS have a measurement method that is based on the fair value of those equity instruments at grant date. However:

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

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

continue to recognise the services received (and hence the resulting expense) over the remainder of the vesting period, as if that grant of equity instruments had not been cancelled.

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

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

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

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

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) As noted in our response to Question 1, we do not propose any further exemptions from the scope of the standard. The standard should apply to all entities, as it will enable the financial statements of companies to be comparable.

b) The possibility of forfeiture should be taken into account in estimating the value of services to be provided. In addition, the amounts credited to equity should therefore not subsequently be reversed if the equity instruments are forfeited as this is consistent with the definition of equity.

c) If an entity settles a grant of equity instruments in cash, it should be regarded as vesting immediately. Accounting for the value of services provided should be discontinued.

d) We support the view that the fair value of equity instruments granted for transactions with parties other than employees should be measured at the grant date. This would be similar to recording a transaction based on contractual terms as opposed to the value of services when they are actually provided. It is consistent with valuing the services based on the expected economic events arising from an agreement without the requirement to reassess when actual services are provided, in circumstances when the payment is a fixed agreed amount.

e) In line with other IFRSs, we support the principle that the value of liabilities should take into account the time value of share appreciation rights.

f) This section suggests that a consequential change is being made to IAS 12 – Income Taxes. However, no such amendment is noted in Appendix E other than to insert a new example in the appendix to the standard. We agree that the tax effects of share-based payment transactions be recognised in profit or loss as part of the tax expense, as the tax is included in the definition of income tax to be included in the income statement and relates to the provision of goods and services to the entity.

Question 25

Do you have any other comments on the Exposure Draft?

In the example given in Appendix B, the value per unit of employee service is calculated. In this case the unit of service is related to the 100 options given to each of the employees. In reality the number of options given to each employee is likely to be different, and accordingly the example should be changed to determine the value for each option, in order to ensure that, when the calculations are carried out, they take the fact that different employees have different numbers of options into account.

Equity compensation plans were excluded from the scope of SIC 12/AC 412 in paragraph 6. Our understanding at the time was that this was done because there was no guidance for accounting for equity-based compensation plans. As this guidance is now given in this standard, this limitation to the scope of SIC 12 should be removed.

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