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IASB and ASB proposals to introduce a reporting standard on Share-Based Payment

A response by The National Association of Pension Funds

The NAPF is the UK's leading body representing the interests of those who provide and support employer-sponsored retirement provision. Today, pension fund assets total many hundreds of billions of pounds and the NAPF itself represents some 1000 plan sponsors as well as over 400 leading organisations providing professional services to those schemes, such as accounting and actuarial.

Preamble

The NAPF strongly believes that the transfer of value inherent in share options is a cost and that the cost should be recognised through the profit and loss account.

For many years, companies in the UK, USA and increasingly in other major economies have been issuing shares and share options to their executives and other employees as part of those employees' remuneration. The positive incentivisation that this provides has been helpful for many companies. For companies in start-up or early growth situations, share-based payment helps them manage the demands on their cash resources by using shares and share options to pay for goods and non-employee services.

For some time, the NAPF has criticised the fact that there is no UK or international accounting standard to set out the accounting treatment to be adopted for the goods and services received and the shares and share options issued. The G4+1 Discussion Paper, issued in July 2000, proposed that share-based payment transactions should give rise to a charge to the profit and loss account for listed companies. The IASB is to be strongly commended for coming forward, following this earlier work, with practical and workable proposals to reflect this in company accounts. Share-based payment to executives and other employees can be good business practice but, to be effective, it needs to be linked to performance and it needs to be properly accounted for. The NAPF, in its earlier response, said that it welcomed the work going on internationally to develop the accounting standard but that it recognised that this needed to happen through international consensus. The NAPF joined with other UK institutional investor groups in writing to the IASB to express their joint support for a convergence agenda to work towards a single international accounting standard which would improve the overall standard of global financial reporting and the accountability of company management to their shareholders and investors.

NAPF responses to the questions raised in the Consultation Document

ASB Q1 *The ASB is proposing to require the adoption in the UK of a standard based on the proposed IFRS from the effective date in the IFRS (which is expected to be accounting periods beginning on or after 1 January 2004). Do you agree with this approach?*

The NAPF would support the implementation in the UK of a standard based on the proposed International Financial Reporting Standard (IFRS) from the effective date of the IFRS. This approach acknowledges the need to ensure that international convergence and harmonisation does not put the success of UK companies at risk. This date may, as suggested, be for accounting periods beginning on or after 1 January

2004 (thus effective in 2005) but for the UK, it should not be in advance of our major international competitors. A 'universal' implementation date is desirable and may be essential.

ASB Q2 *The IASB has concluded that its standard should apply to all entities. The ASB does not believe there are any conceptual or practical reasons why that conclusion should not apply equally in the UK. It is therefore proposing that all UK entities, other than those that are applying the FRSSE, should be required to prepare their financial statements in accordance with the proposed standard. Do you agree with this proposal?*

The NAPF is chiefly concerned that share incentive schemes and executive share options, in particular, should be charged as an expense in publicly listed company accounts.

ASB Q3 *The IASB has concluded that its standard should apply to all types of share-based payment transactions, including SAYE-type share purchase plans. The ASB does not believe there are any additional UK considerations that would justify a different conclusion being reached in the context of UK accounting. Therefore, like the IASB the ASB is proposing that the standard should apply to all types of share-based payment transaction. Do you agree with this proposal?*

The NAPF supports the proposal that the standard should apply to all types of share-based payment transactions except that the UITF's failure to reach consensus in the case of SAYE, where values tend to be de minimis, seems grounds for retaining such an exception to the general rule. SAYE schemes are seen as an important motivational tool to encourage participating employees to work together for the good of the company. It is correct that they too represent a transfer of value. However, they are not financially significant and, with strict governmental financial limits in place, are not capable of being exploited.

The NAPF does not consider that SAYE saving schemes are part of remuneration, because many employees (by declining the offer) choose not to save in this way. They are a form of flexible benefit provided under an umbrella of Inland Revenue approval and preferential terms, but the cost is met by the employees participating, not by their employers. Scheme administration costs are absorbed by the providers. This distinguishes SAYE from other all-employee benefits such as SIPs and previous forms of ESOP "approved profit sharing" in which free or discounted share packages were provided to employees by their employers. The Inland Revenue allow an up to 20% initial discount as a potential tax-free benefit. The anti-dilution protection to shareholders (who vote on whether SAYE can be offered in any case) is that the total number of shares offered under SAYE counts towards any pre-emption thresholds (typically up to 10% of shares in issue cumulatively).

An exemption for SAYE schemes would be supported by the NAPF. In the US (see Q24) SFAS 123, which allow up to 15% discount, excludes employee share purchase plans where specified criteria are met. (See also IASB Q15.)

ASB Q4 *The IASB is proposing that its standard should apply equally to all individual entity financial statements and consolidated financial statements, regardless of whether for example the reporting entity is a wholly-owned subsidiary of a group that prepares consolidated financial statements or a parent company that also prepares consolidated financial statements. The ASB does not believe there are any additional UK considerations that would justify a different conclusion being reached in the context of UK accounting and is therefore proposing to adopt the same approach as the IASB. Do you agree with this proposal?*

Agree, although NAPF members are chiefly concerned with publicly listed companies and with private equity vehicles.

and with private equity vehicles.

ASB Q5 *The ASB is proposing that, when the share-based payments standard is implemented in the UK, the ASB should withdraw UITF Abstract 10 'Disclosure of directors' share options' (if it has not already been withdrawn by then), UITF Abstract 13 'Accounting for ESOP Trusts', and UITF Abstract 17 'Employee share schemes'. It also acknowledges that consequential amendments may need to be made to UITF Abstract 32 'Employee benefit trusts and other intermediate payment arrangements'.*

(a) Will these amendments to existing UK requirements be sufficient to enable entities to adopt the proposed standard without being in breach of an existing requirement?

(b) Are any of the amendments unnecessary for this purpose?

(a) The NAPF believes this to be the case.

(b) UITF Abstract 17 'Employee share schemes' remains relevant (see Q3 above)

ASB Q6 *The FRED proposes that entities should be required to apply the requirements of the standard to equity-settled share-based payment transactions that were granted after the publication date of the FRED but had not vested at the effective date of the standard. Full retrospective application would not be permitted (unless it can be achieved through early adoption) and nor would prospective application. Do you agree with this proposal?*

(IASB Question 22 also focuses on the transitional requirements set out in the proposed standard.)

The ASB would also welcome comments on the questions that the IASB has asked in its exposure draft, which are as follows:[1]

The NAPF supports the proposed transition line recommended by the ASB. It is important to shareholders that there are clear and pragmatic rules. The NAPF would not object, if standard-setters suggest other transitional arrangements, as long as the rules were clear and capable of being implemented in a reasonable timescale.

IASB Q1 *Paragraphs 1-3 of the draft IFRS set out the proposed scope of the IFRS. There are no proposed exemptions, apart from for transactions within the scope of another IFRS.*

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

The NAPF strongly supports the objective of the IFRS Share-Based Payment proposals. The NAPF has long argued that all share incentive schemes, and share options in particular, should be charged as an expense in publicly listed company accounts. And that there is a clear and pressing need for this to be taken forward within an international framework. The three types of share-based payment transaction identified – equity settled, cash settled or settlement in lieu of goods or services would seem to reflect the range of applicable transactions as it is assumed that these would include any hybrid options involving other convertible securities.

IASB Q2 *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?

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1 It is worth noting that the IASB prefaced its invitation to comment by noting that "comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording."

The NAPF supports the underlying principle of using fair value as a foundation concept. This is a widely understood term that has already received recognition from both the preparers and users of financial statements. The NAPF notes that, in order to estimate the fair values needed to account for options, the use of an option-pricing model is supported. Whilst the draft IFRS does not require any particular model to be used it does offer guidance. It may be that, going forward, a tightening to reflect a list of acceptable models will become necessary. However, the NAPF recognises that this is a relatively new area and one that market requirements are likely to stimulate and refine option-pricing models.

Whatever model is chosen, it is essential that its application, in the context of individual companies, is properly controlled. It would throw the whole process into disrepute if companies took widely different interpretative stances leading to significantly different results. Results "gaming" would ultimately be unhelpful to all sides. Therefore, the NAPF suggests that use of the model should be either part of an audit process or independently verified and accompanied by a statement in the annual report to this effect.

IASB Q3 *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?

Equity-settled share-based payment transactions are like cash-settled transactions, except that the exchange involves agreeing to issue equity instruments to the counterparty. The NAPF considers that, at the date the transaction is entered into, the entity believes that the value of the promises it is making is equal to the value of the goods or services it expects, at grant date, to receive in return. The most likely method of arriving at the fair value of equity-settled transactions should be the fair value of the goods or services received which should be reasonably straightforward to establish. However, the NAPF notes that, where this is not achievable, the fair value of the equity instruments granted is to be used. The NAPF supports this approach.

IASB Q4 *If the fair value of the goods or services received in an equity-settled share-based payment transaction is measured directly, the draft IFRS proposes that fair value should be measured at the date when the entity obtains the goods or receives the services (paragraph 8).*

Do you agree that this is the appropriate date at which to measure the fair value of the goods or services received? If not, at which date should the fair value of the goods or services received be measured? Why?

The NAPF supports the IASB's proposal that the fair value of goods or services is determined by the normal recognition points of goods received or services rendered.

IASB Q5 *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?

The NAPF initially preferred the use of an exercise date since was seen as the best method of ensuring that the final entry in the company accounts fully reflects the value of the share options. As an alternative, because the NAPF recognises the difficulty that breaking the fundamental accounting principle – which does not allow equity to be re-valued – the use of vesting date has been suggested as a workable compromise.

The use of grant date does not take account of expected future price uplift, nor does it deal with issues of non take-up of options. Nevertheless, the NAPF now supports the grant date methodology but strongly urges that a statement of cumulative, not just annual, value should also be disclosed in the accounts or the remuneration report to shareholders.

IASB Q6 *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?

The NAPF agrees with the rebuttable principle, in this context, that the fair value of the goods or services received is more readily determinable than the fair value of the equity instruments granted.

IASB Q7 *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 not so?

The NAPF agrees with the sentiments expressed in paragraph 12 of the Exposure Draft and accepts that estimating the fair value of shares, options etc. is not straightforward and requires the exercise of judgement. The essential requirement is to match cost with period of service to ensure correct alignment. Nonetheless, it should be feasible to achieve a satisfactory estimate. Therefore, the NAPF supports the IASB proposal with the caveat that, as set out in the answer to Q2, the fair value estimate should be accompanied by an auditing or verification statement.

IASB Q8 *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?

The NAPF agrees that it is pragmatic and reasonable to presume that the services rendered by the counterparty as consideration for the equity instruments are received during the vesting period.

IASB Q9 *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?

The NAPF agrees. Matching of cost with service received is necessary. Again, audit or verification of this should be a requirement of the proposed standard.

IASB Q10 *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 NAPF considers the question to be unclear. The comment *"…this requirement does not preclude the entity from recognising a transfer with equity …"* is itself confusing. What exactly is proposed? The whole problem of non-adjustment where equity instruments do not vest (or are not exercised) is an inevitable consequence of choosing grant date. Under grant date, the accounting inaccuracies covered by non-vesting etc. are being charged to distributable reserves which have the effect of unnecessarily restricting future dividends. If grant date is utilised, there needs to be a mechanism to allow dividend capacity to be restored. Dividends are a major means of rewarding shareholders.

Some commentators have suggested that the value charged as an expense at time of grant, in the case of options which later never vest because they become under water, represents the fair value of hedging that issue on the basis of market information at date of grant. The NAPF would like more consideration to be given to allowing an exception to the principle of no further revaluation/remarking to market for such equity instruments.

IASB Q11 *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?

As set out in our response to IASB question 2 above, the NAPF recognises that option pricing models and auditing/verification will have to be used where circumstances make this necessary. The NAPF is not aware of circumstances where it would be inappropriate or impracticable to take into account the factors listed in Question 11 above in applying an option pricing model.

IASB Q12 *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?

The NAPF agrees that, for non-transferable options, the option's expected life rather than its contracted life should be used in applying an option pricing model. Where options are transferable, the option's contracted life should be used. One area of potential problem is what is the position whereby a ten year option is cashed in after, say, three years? There would not appear to be an appropriate accounting mechanism to allow for this.

IASB Q13 *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?

The NAPF agrees subject to the need for independent verification/audit and an appropriate statement in the annual accounts (see answer to Q2).

IASB Q14 *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?

The NAPF agrees that, whenever a reload option is granted, it should be treated as the grant of a new option. Again, this is a flaw in the use of option grant as a basis.

IASB Q15 *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?

The NAPF is not aware of any other common features of employee share options where the IFRS needs to specify requirements. However, the points made in question ASB3 are also relevant here especially regarding share-saving plans under SFAS 123.

IASB Q16 *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*

Q16 *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?

This is reasonable, however, the methodology basis used should be disclosed and its use and application monitored (see answer to IASB Q2).

IASB Q17 *If an entity reprices a share option, or otherwise modifies the terms or conditions on which equity instruments were granted, the draft IFRS proposes that the entity should measure the incremental value granted upon repricing, and include that incremental value when measuring the services received. This means that the entity is required to recognise additional amounts for services received during the remainder of the vesting period, i.e. additional to the amounts recognised in respect of the original option grant. Example 3 in Appendix B illustrates this requirement. As shown in that example, the incremental value granted on repricing is treated as a new option grant, in addition to the original option grant. An alternative approach is also illustrated, whereby the two grants are averaged and spread over the remainder of the vesting period.*

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

The NAPF agrees with the proposed reflection of incremental value granted and suggests that cumulative disclosure should be made. As far as re-pricing of share options is concerned, the ABI/NAPF position is that re-pricing is allowed after rights issues, share buybacks and capital reconstitutions (e.g. share consolidations or sub-divisions) but not for underwater or too challenging existing options. The NAPF also has a concern that companies tend to re-price options after rights issues (when it is reasonable to expect existing options to be re-priced at a lower price as more options available e.g if original options were 1000 at 100 and company does a 1-for-1 rights issue then re-priced options become 2000 at 50) but not after a share buyback (when the expectation is that existing options be re-priced at a higher price as there are less of them).

IASB Q18 *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.

Agreed, but see also answer to Q10.

IASB Q19 *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.

The NAPF agrees that it will be necessary to remeasure the fair value of the liability at each reporting date, if it is “material”, and that subsequent changes in value be each reporting date, if it is “material”, and that subsequent changes in value be reflected in the income statement. Where ‘phantom’ options are involved, greater transparency is needed.

IASB Q20 *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.

No views.

IASB Q21 *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)?

A requirement for cumulative disclosure should be added. Cumulative disclosure of all individual directors and, say, the five highest in the company outside the Board is suggested.

IASB Q22 *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.

No particular views but see answer to ASB Q6.

IASB Q23 *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?

Yes.

IASB Q24 *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* *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.[2]

The NAPF notes that SFAS 123 contains some exclusions for employee share purchase plans. For the reasons set out in the NAPF's answer to ASB Q3 this exemption is supported.

IASB Q25 *Do you have any other comments on the Exposure Draft?*

The NAPF considers that it will be essential to keep the implementation of the proposals under review as use and experience of the standard (on the assumption that it will be actioned) develops. It may be necessary to amend or correct the reporting standard on share-based payment in the light of experience.

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2 In the IASB's Invitation to Comment, it points out that "further details of the differences between the draft IFRS and SFAS 123 are given in the FASB's Invitation to Comment."