CCDG
COUNCIL ON CORPORATE
DISCLOSURE & GOVERNANCE

CL 160

14 March 2003

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sirs,

RESPONSE TO EXPOSURE DRAFT ED 2 SHARE-BASED PAYMENT

The Council on Corporate Disclosure and Governance (CCDG) appreciates the opportunity to comment on the Exposure Draft ED 2 *Share-based Payment* published by the International Accounting Standards Board (IASB) in November 2002. Our comments are divided into General Comments and Responses to Specific Questions set out in the "Invitation to Comment" section. Our comments are given in the context of the IASB's Framework for the Preparation and Presentation of Financial Statements considering, *inter alia*, the recognition and measurement criteria therein, whether alternatives are permitted and the adequacy of requirements or guidance.

General Comments

2. The CCDG is currently seeking comments to a public consultation in Singapore on the fundamental issue of whether share-based payment transactions involving grants of shares or share options should be accounted for in the same way as other transactions in which an entity receives resources as consideration for its equity instruments including recognizing an expense for the consumption of the resources received, whether in the form of employee services, other services, or goods. Consequently, the CCDG has not reached a decision on this issue and our responses to the specific questions that have been written on the presumption that such share-based payment transactions are recognised as expenses are subject to the CCDG reaching a decision on this and should be read in this context.

Responses to Specific Questions

3. The CCDG has not reached a decision on whether share-based payment transactions should be recognised as expenses and the responses to the specific questions below which have been written on the presumption that such share-based payment transactions are recognised as expenses are subject to the CCDG reaching a decision on this and should be read in this context.

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?

Yes, the CCDG is of the view that the proposed scope of the IFRS is appropriate. The proposed IFRS should enhance the neutrality, transparency, comparability and consistency of financial reporting.

Question 2

Paragraphs 4-6 of the draft IFRS propose requirements for the recognition of share-based payment transactions, including the recognition of an expense when the goods or services received or acquired are consumed.

Are these recognition requirements appropriate? If not, why not, or in which circumstances are the recognition requirements inappropriate?

Yes, the CCDG is of the view that the proposed requirements for the recognition of share-based payment transactions are appropriate. The consumption of goods and services received or acquired generally represents expenses and should be accounted for as such.

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?

Yes, the CCDG is of the view that the proposed measurement principle for share-based payment transactions using fair value is appropriate. However, we are of the view that guidance should be provided on what constitutes "more readily determinable" or cite factors to be taken into consideration therein.

Question 4

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

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

No, the two issues on recognition and measurement of fair value seem to have been confused. ED 2 seems to imply that where the fair value of goods and services is used as the basis for measurement of the transaction, the measurement and recognition of the fair value is at the date the goods or services are received. This is inconsistent with generally accepted accounting practice where the recognition would normally be the date when the goods and services are received, and measurement should be a contracted rate, or agreed invoice price or per purchase order etc, which may be at an earlier date. Clarification is needed in this aspect.

Question 5

If the fair value of the goods or services received in an equity-settled share-based payment transaction is measured by reference to the fair value of the equity instruments granted, the draft IFRS proposes that the fair value of the equity instruments granted should be measured at grant date (paragraph 8).

Do you agree that this is the appropriate date at which to measure the fair value of the equity instruments granted? If not, at which date should the fair value of the equity instruments granted be measured? Why?

Yes, the CCDG agrees that where the fair value of the goods and services received in an equity-settled share-based payment transaction is measured by reference to the fair value of the equity instruments granted, the fair value of the equity instruments granted should be measured at grant date. Please also see our response to Question 3 above.

Question 6

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

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

Yes, the CCDG agrees that the fair value of the goods or services received is usually more readily determinable than the fair value of the equity instruments granted.

Question 7
For equity-settled transactions with employees, the draft IFRS proposes that the entity should measure the fair value of the employee services received by reference to the fair value of the equity instruments granted, because the latter fair value is more readily determinable (paragraphs 11 and 12).

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

Yes, the CCDG agrees that the fair value of the equity instruments granted is more readily determinable than the fair value of the employee services received.

Question 8
Paragraphs 13 and 14 of the draft IFRS propose requirements for determining when the counterparty renders service for the equity instruments granted, based on whether the counterparty is required to complete a specified period of service before the equity instruments vest.

Do you agree that it is reasonable to presume that the services rendered by the counterparty as consideration for the equity instruments are received during the vesting period? If not, when are the services received, in your view?

Yes, the CCDG agrees 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.

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 to you propose?*

Yes, the CCDG agrees with both the proposal to determine the amount to attribute to each unit of service received where the fair value of the equity instruments granted is used as a surrogate of the fair value of the services received and the manner of computing this amount.

Question 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 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 recognizing a transfer with 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?

Yes, the CCDG agrees with the proposed requirement. However, the proposed requirement of the prohibition of the reversal of entries (write-back to P&L) when the options are subsequently forfeited or lapsed, etc appears to be inconsistent with SFAS 123.

Question 11
The draft IFRS proposes that the entity should measure the fair value of equity instruments granted, based on market prices if available, taking into account the terms and conditions of the grant (paragraph 17). In the absence of a market price, the draft IFRS proposes that the entity should estimate the fair value of options granted, by applying an option pricing model that takes into account various factors, namely the exercise price of the option, the life of the option, the current price of the underlying shares, the expected volatility of the share price, the dividends expected on the shares (where appropriate) and the risk-free interest rate for the life of the option (paragraph 20). Paragraph 23 of the proposed IFRS explains when it is appropriate to take into account expected dividends.

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

Yes, the CCDG agrees that an option pricing model should be applied to estimate the fair value of options granted. However, the use of an estimated market price in the case where

an entity's shares are not publicly traded, or there are no similar traded options, or where there is a lack of available information on various factors used in the option pricing model may make the exercise of option of valuation or pricing very subjective.

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?

Yes, the CCDG agrees with both proposals on the use of the expected life of an option and the inability to exercise an option during the vesting period. However, since it is non-transferable, it would be useful to issue more guidance with regard to expected life in order to reduce the impact of subjectivity.

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?

Yes, the CCDG agrees 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?

Yes, the CCDG is of the view that the proposed requirement is appropriate.

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?

None that we can think of at this point in time.

Question 16
The draft IFRS does not contain prescriptive guidance on the estimation of the fair value of options, consistently with the Board's objective of setting principles-based standards and to allow for future developments in valuation methodologies.

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

Yes, the CCDG agrees with the principles-based approach of the proposed standard on share-based payment. However, the CCDG is also of the view that appropriate and adequate disclosure of relevant information on the estimation of the fair value of the options should be made. The alternative option pricing models and the estimation process would tend to introduce an element of flexibility which could potentially result in a loss of comparability of financial information.

Notwithstanding our preference for the principles-based approach for standard setting, given that the proposed IFRS deals with a new accounting treatment, both users and preparers would find additional guidance helpful in implementing the standard. For example, it may be useful to allow the modification of assumptions used in the option pricing model (like expected volatility) in the case of unlisted entities.

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 requested. This means that the entity is required to recognize additional amounts for services received during the remainder of the vesting period, i.e. additional to the amounts recognized in

respect of the original option grant. Example 3 in Appendix B illustrates this requirement. As shown in the 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?

Yes, the CCDG agrees that the incremental value granted should be taken into account when measuring the services received. Of the two methods illustrated in Example 3, we would tend to consider the first method preferable over the latter as the first method would more accurately reflect the economic reality and timing of the granting of the option in the first instance and the repricing in the subsequent instance. Allowing the two grants to be averaged and spread over the remainder of the vesting period may introduce some scope for gaming.

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 recognize 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.

Yes, the CCDG is of the view that the proposed requirements in respect of cancelled share or option grants are appropriate.

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 recognized in the income statement.

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

Yes, the CCDG is of the view that the proposed requirements in respect of measuring and remeasuring the liability for cash-settled share-based payment transactions are appropriate.

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.

Yes, the CCDG is of the view that the proposed requirements for share-based payment transactions in which the supplier has a choice to settle the transaction in cash or equity are appropriate.

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)?

Yes, the CCDG is of the view that the disclosure requirements are appropriate.

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.

Yes, the CCDG is of the view that the proposed requirements on the timing of the application of the IFRS are appropriate.

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 recognized in the income statement.*

Are the proposed requirements appropriate?

Yes, the CCDG is of the view that the proposed consequential amendment to IAS 12 (revised 2000) is appropriate.

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 planes 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 recognize 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 recognized 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 recognized 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 recognized is recognized 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 recognize 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 the 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 realized 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 recognized 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 recognized 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 difference between the draft IFRS and SFAS 123 are given in the FASB's Invitation to Comment.)

(a) **As per our response to Question 1, the CCDG is of the view that the proposed IFRS should not contain exemptions from the requirement to apply the IFRS or to measure share-based payment transactions at fair value. Please also refer to our response to Question 16.**

(b) **The CCDG is of the view that the measurement method using the fair value model taking into account forfeiture in estimating and measuring the deemed fair value of the employee services received as proposed in the IFRS is preferable as the treatment is a better reflection of economic reality. No subsequent adjustment is preferable to the treatment prescribed in SFAS 123.**

(c) **The CCDG is of the view that the recognition principle in ED 2 is preferable for the same reason as in (b) above, i.e., it is a better reflection of economic reality.**

(d) **The CCDG is of the view that the IFRS proposal in measuring the fair value of equity instruments at grant date in all cases is preferable as this would accord consistent treatment and enhance comparability.**

(e) **The CCDG is of the view that the IFRS proposal on using the fair value model over the intrinsic value model is more appropriate as fair value is a better reflection of economic reality.**

(f) **The CCDG is of the view that the IFRS proposal on recognizing all tax effects of share-based payment transactions in profit or loss, as part of tax expense is preferable on the grounds of consistent treatment and comparability.**

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

A flowchart outlining various criteria and option pricing models available could be useful to the users of financial statements in determining the accounting treatment.

4. We shall be pleased to discuss our comments and views with the Board or its staff. Please contact Mr Ramchand Jagtiani, Deputy Director, at the Institute of Certified Public Accountants of Singapore via email at jagtiani@icpas.org.sg should you require further information. Thank you.

Yours sincerely,

Chee Hong Tat
Secretary, CCDG