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SPANISH ACCOUNTING AND AUDITING INSTITUTE (ICAC)

COMMENTS ON ED 2 *SHARE-BASED PAYMENT*

Share and share option plans are a common feature of employee pay, not only for directors and senior executives, buy also for many other employees. Some entities issue shares or share options to pay suppliers, such as suppliers or professional services. So we welcome the IASB ED 2- “Share-Based Payment” in order to ensure that an entity recognises all share-based payments transactions in its financial statements, measured at fair value, so as to provide high quality, transparent and comparable information to users of financial statements so that IFRS financial statements meet the qualitative characteristics of understandability, relevance, reliability and comparability.

These criteria for share-based payments, have been developed and published by the Spanish Accounting and Auditing Institute (ICAC) as follows:

1. Share based payments to the employees (BOICAC 45, March 2001)

The characteristics of the operation are the following ones; the entity has a portfolio of own shares to be delivered as they plan to issue share options, those options will be granted to the employees depending on the satisfaction of certain economic aims. The exercise price of the options will be fixed when the targets are achieved; though the exercise of the option will only be able after certain time from its grant. For the granting the employees do not spend any money.

The accounting treatment of this specific operation is the following:

1. The commitment of the entity with the employees should be shown through a charge in the profit and loss account from the grant date to the vesting date.

2. The measurement of the charge (the real cost to the entity) should be the difference between the exercise price of the share option and the market price of the shares.

3. As the performance occurs between the grant date and the vesting date, the entity should account for an accrual of the best estimation of the transaction amount during the performance period. Re-estimating if the entity considers it is necessary to show the exchange of the very same real values.

4. When the employees exercise the share options, the provision should be credited (even though the options will not be exercised), the shares will be granted and the entity will account for an income of the exercise price of the options received.

2. Share based payments to the employees (BOICAC 38, June 2000)

The question refers to the accounting treatment on an entity that issues shares to pay employees services.

First of all, we have to take into account that from an economic and rational perspective the operation can be described as a real transaction. The services are obtained but the payment takes the form of shares issued by the entity. For that reason, the accounting treatment proposed is the following:

- The expense must be recognised, as there is a real cost to the entity.

- The valuation of the expense should be done based on its purchase price or production cost, and accounted for during the performance period.

- If it exists a commitment of the entity with the employees so that if certain circumstances are fulfilled they will be paid, no matter the form of the instrument used for the payment that will produce the accrual of that amount over the performance period.

- Finally, we have to take into account that there should be a balance between the cost of the services and the value of the shares issued in exchange for the services received. That is to say that in the accounting should be shown an exchange of the very same real values.

- In this specific operation, the difference between the debt value and the value of the share issued should be accounted for in accordance with the whole operation sense. That is to say that the difference should be shown as equity, specifically in the share premium account.

In respect with the EFRAG 's draft comment letter, we would like to make the following comments:

1. We believe hat the Board should consider clarifying the definition of an expense in the Framework.

2. We support the EFRAG comment about recommending the Board to modify para 11 and 12 such that they propose a rebuttable presumption that, for equity-settled transactions with employees, the fair value of the equity instruments granted is more readily determinable than the fair value of the employee services received.

3. We do not support the IASB proposal related with the mixed measurement approach depending on whether the transaction is made between the entity and the employees or the entity and other third parties.

We see no reason to draw any distinction between share-based payment transaction. The basic transaction is the same, namely the receipt of goods or services as consideration for the issue of shares or share options. Therefore, any conclusions about which measurement basis and measurement date should be applied are, in principle, equally applicable to share-based payment transactions with other than employees.

4. In relation with the measurement date, we do not support neither the IASB or the EFRAG comments, we consider that the vesting date is the best one, as it is the date at which the employee, having satisfied all the conditions necessary, becomes unconditionally entitled to the option.

   From an economic and rational perspective we can describe the operation as a real transaction. The goods and services are obtained but the payment takes the form of shares issued by the entity that benefits from the delivery instead of cash. The charge must be recognised, as there is a real cost to the entity. The peculiarity is that the payment will be done by issuing shares not by cash, but the fact of the matter is the very same in both cases. Consequently, the economic and, therefore, accounting treatment should be the same. According to that the accounting treatment should be the following:

   - The expense must be valued based on its purchase price or production cost, and accounted for during the performance period.

   - To this respect, if it exits a commitment of the entity with the employees so that if certain circumstances are fulfilled they will be paid (no matter the form of the instrument used for the payment), that will produce the accrual of that amount over the performance period. That will permit to show the commitment acquired in the form of the provision that will correspond to the transaction amount.

   - Furthermore, any change in the considerations made initially should be reflected, so that, at the end of the performance period the transaction made should be balanced.

5. Finally, we support the IASB proposal related with the disclosure requirements, as we consider them necessary, so that IFRS financial statements meet the qualitative characteristics of understandability, relevance, reliability and comparability.

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?

<u>Response</u>

We agree with the EFRAG response.

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?

<u>Response</u>

We support the EFRAG response. We also believe that the definition of an expense in the Framework should be modified.

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?

<u>Response</u>

We agree with the IASB proposal, though we see no reason to draw any distinction between share-based payment transactions. The basic transaction is the same, namely the receipt of goods or services as consideration for the issue of shares or share options. Therefore, any conclusions about which measurement basis and measurement date should be applied are, in principle, equally applicable to share-based payment transactions with other than employees.

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?

Response

We believe that the one date to measure should be when the entity obtains goods or receives the services .

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?

Response

We de not support the IASB proposal for the reasons explained in question 4.

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?

Response

We support the EFRAG's answer.

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 is not so?

Response

We support the EFRAG proposal..

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?

Response

We think that IASB and EFRAG proposals are the same and, if the Standard is rightly applied, they lead to the same results. We think that EFRAG just introduce an additional case.

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?

Response

We support the IASB proposal referred to measure originally “the fair value of the unit of service”, taking into account the best estimates of the model inputs (including vesting conditions and the other significant parameters: volatility, etc.). Nevertheless, if it is seen that anyone of the assumptions or initial estimates are wrong, the originally measured fair value should be restimated.

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, ie a transfer from one component of equity to another.

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

Response

If services are received and recognised and the transactions finally is not settled, a revenue must be recognised in profit or loss.

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?

Response

We support the EFRAG’s answer.

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?

Response

We support the EFRAg's answer, though we think that references to one class of vesting conditions (paragraph 22) should be taken to Appendix or Application Guidance.

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?

Response

Although we do not understand the first paragraph of the EFRAG response, we think IASB proposal is right in reference to the initial measurement of the fair value, and it should be readjusted depending on the vesting conditions evolution.

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?

<u>Response</u>

We support the EFRAg's answer

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?

<u>Response</u>

We support the EFRAG's answer.

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 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?

<u>Response</u>

We support the IASB proposal, but we think it should be necessary to develop some guidelines for the application of the reference models in order to calculate the fair value of the options. This could be compatible with the Board's objective of setting principles-based standards.

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?

Response

We support the EFRAG's answer.

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.

Response

We support the EFRAG's answer.

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.

Response

We support the EFRAG's answer.

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.

Response

We support the EFRAG's answer.

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)?

Response

We support the IASB proposal as we do not consider excessive the disclosure requirements stated in the Draft.

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 (ie the amount that would have been paid on settlement of the liability had the counterparty demanded settlement at the date the liability is measured).

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

Response

We support the EFRAG's answer.

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?

<u>Response</u>

We think that the increase in the equity must be netted of tax effects.

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 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.

Response

We prefer the SFAS 123 proposal stated in point (c) and we support the EFRAG's answer. In point (d), we consider that the best measurement date is on receiving services. In point (b), we agree with IASB proposal in reference to introduce probability in the calculation system, and we refer to answer to Q10 with respect to reversal. In point (f), we prefer SFAS 123 position, consequently with our answer to Q18.

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

Other comments

We support the EFRAG response.