BNP PARIBAS

CL 105A

7 March 2003

Sir David Tweedie
International Accounting Standards Board
30 Cannon St
London EC4M 6XH
United Kingdom

Re: Exposure Draft ED 2: Share-Based Payment.

Dear Sir David,

We are pleased to provide our comments on the above Exposure Draft which reflect joint deliberation between ourselves and Société Générale.

We have fundamental concerns with the approach proposed in the Exposure Draft. We do not believe that it is appropriate to recognise an expense for equity-settled share-based plans attributed to employees. We disagree with the Board's view that shares or share options attributed to employees are an additional remuneration for services rendered by those employees to the enterprise. There are several reasons why share options are attributed to employees. One of them is to create a community of shareholders dedicated to the enterprise. Another reason is that the shareholders wish to give an incentive to the employees to create added value for them. Employee equity-settled share-based plans are therefore transactions between current and future shareholders, which will not result in an outflow of resources embodying economic benefits flowing from the enterprise. Therefore, it would be inappropriate to recognise them as an expense in the income statement. They should be recognised in equity.

Should the IASB continue to believe that an expense should be recognised in all circumstances, including for employee equity-settled share-based plans, we also disagree with the fact that there is no adjustment to any expense previously recognised in the financial statements when it becomes probable that the vesting conditions related to employees' performance will not be met. If it is considered that share options are a remuneration of employees' service, why should an expense be recognised when the employees do not deliver the requested performance (and therefore will not be able to exercise the share options)? If the performance is not met, no expense should be recognised.

Furthermore, we also want to highlight that the recognition of an expense for employee shared-based plans having vesting conditions related to employees' performance will often be on the basis of a number for which the reliability of the estimate at the grant date could be questioned. Indeed, behavioural factors (which are a reality) will have to be considered in the determination of the fair value of the options granted and, currently, techniques are not sufficiently developed to be able to model them appropriately. This practical consideration is also why we believe that, when there are vesting conditions related to employees' performance, an adjustment to any expense previously recognised should be made when it becomes probable that the performance conditions will not be met.

Finally, we support convergence of IFRS and US GAAP towards a common solution on the topic of share-based payments. We believe that as long as the FASB and the IASB have not come up with a solution that would be applicable at the same time to both US companies and IFRS issuers, the IASB should not issue a Standard on share-based payments. We believe that it would put IFRS issuers at a competitive disadvantage with US companies.

We detail in Appendix 1 our views on ED 2.

If you have any queries regarding our comments, please do not hesitate to contact me at 33 (0)1 40 14 29 28.

Regards,

Philippe BORDENAVE
Chief Financial Officer

Cc: Conseil National de la Comptabilité

Appendix 1
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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?

We disagree with the inclusion of employee equity-settled share-based plans in the scope of the Standard, if this results in their systematic recognition as an expense in the income statement (under a logic of "form over substance"). They should either be excluded from the scope of the Standard or, alternatively, be included in the scope but their treatment should clarify that they are often transactions with the enterprise's owners and should result in equity recognition.

ED2.1(a) requires that "*equity-settled share-based payment transactions, in which the entity receives goods or services as consideration for equity instruments of the entity*" should be dealt under the proposed Standard. We believe that employee equity-settled share-based plans are not necessarily attributed to be a remuneration of services and, therefore, should not always be dealt with by the Standard.

Practices in our groups are such that share options are attributed by the shareholders to certain individuals in order to create a community of individuals with a shared interest to them. There is a belief that management behaved differently when they are also shareholders. Therefore, the objective of share options attribution is not a remuneration of a service, which is paid separately, but to influence the behaviour of those selected individuals for the benefits of the whole shareholder community. The beneficiaries of share options also do not consider that the share options they are granted are part of their remuneration package, but they are an incentive to create value for shareholders, the community to which they belong.

The objectives of share option plans attributed to employees are as follows:

(a) to create a community of individuals dedicated to the enterprise and with a shared interest. For example, this is the purpose of our "Plans Epargne Entreprise", which are equity-settled share-based plans attributed to potentially all of the enterprise's employees. Those plans do not include vesting conditions but they require the decision of employees to sign up to it and to buy shares. We definitely do not view these plans as an additional remuneration given to employees (and many employees choose not to take part in these plans because they do not want to become shareholders). They aim to create a stable number of shareholders fully dedicated to the enterprise; and

(b) to create an incentive to create value to the shareholders, since the employees will belong to them.

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We believe that these transactions are truly transactions between the employees and the shareholders. They are not transactions with the enterprise, as a remuneration of service. To demonstrate further our point, in our environment and organisations:

(a) equity-settled shared-based plans must be approved by the shareholders at their general assembly meeting or through a shareholders' delegation to the entity's board of directors. Management alone does not have authority to decide equity-settled share-based plans;

(b) share options attributed to employees are not viewed as an additional remuneration: during remuneration negotiations, they are not valued as a portion of the global remuneration package. Also, except for the "Plans Epargne Enterprise" mentioned above, stock options often are attributed on a discretionary basis rather than according to a logic of an employees' compensation for services rendered by them;

(c) beneficiaries are not allowed to sell such shares for several years (typically five years) because the other shareholders want them to remain shareholders for a long time, which is consistent with the behavioural purpose of such scheme.

As a result, since we do not believe that such employee equity-settled share-based plans are granted as a consideration of employees' service, we disagree that they should be included in the scope of the Standard.

However, note that we agree that other share-based payments should be dealt with under the proposed Standard. The point is to cover only those share-based payments that are relating to goods and services received (substance over form).

As an additional comment on the scope of the Standard, we would appreciate if the IASB could give further guidance on the treatment of share or share option plans that are attributed during a business combination to the sellers of an entity, when those individuals remain employees of the acquiree. Are such plans included in the scope of the Standard or in the scope of IAS 22, Business Combinations? Where the sellers of a business become the enterprise's employees and they receive shares or share options at the time of the business combination to ensure that they will maintain the goodwill of that business, we believe that those share or share options grants are part of the business combination transaction and should be accounted for under IAS 22.

Question 2

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

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

We agree that an expense should be recognised when goods or services received or acquired are consumed, for those share-based plans that we believe should be dealt with under the Standard. However, as we explain in Question 1, we believe that no expense should be recognised in the financial statements for equity-settled share-based plans. We believe that most equity-settled share-based plans are the results of a direct transaction between the shareholders and employees, without any direct link to any service rendered. Therefore, it would be inappropriate to recognise an expense in an entity's financial statements in such a case. The transaction should give rise to equity movements only.

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?

Note: our response below is subject to our comments on Question 1, i.e. that the proposed Standard does not deal with employee equity-settled share-based payments or, alternatively, that such plans should give rise to equity movements only.

Measurement at fair value

We agree with the principle that an entity should measure the goods or services received at the fair value of the transaction.

Measurement of fair value

We disagree with a distinction as to whether the fair value of the goods or services received or the fair value of the equity instrument granted is "*more readily determinable*". We believe that the IASB should be consistent with existing principles and that the fair value of the transaction should be measured based on the amount that is the more reliably determinable. In some cases, the fair value of the equity instrument will be more reliably measurable, in other cases it will be the fair value of the goods and services received.

To illustrate our comments, imagine an entity whose shares are not listed (and for which no valuation based on prior transactions exists) and that grants share options to its consultants in the tax department if they meet certain performance conditions. It may be more reliable to measure the fair value of the transaction by comparison with market rates for tax consultants rather than determine the fair value of the entity's equity instruments granted.

As another example, imagine a listed entity that enters into a service agreement with a service provider operating in a very specialised field, for which payments consist of simple, negotiable warrants. In this case, it may be more reliable to measure the fair value of the transaction based on the fair value of the entity's equity instruments granted rather than determine the fair value of the services to be received.

Unlisted entities

We note that IAS 39 provides a special exemption to fair value measurement in those cases where the fair value of an equity instrument cannot be measured reliably. However, we agree that there should be no exemption for the measurement at fair value of share-based payment transactions, even if they involve unlisted entities. This is because we believe that, even if the fair value of the equity instrument granted cannot be reliably determined, it is likely that the fair value of the goods or services received can be determined reliably.

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?

Note: our response below is subject to our comments on Question 1, i.e. that the proposed Standard does not deal with employee equity-settled share-based payments or, alternatively, that such plans should give rise to equity movements only.

We disagree with the proposed requirements (which by the way we had difficulty to understand in the first place) and we see some inconsistencies with the current literature.

For the purchase of goods, we believe that the fair value of the goods acquired generally should be measured when the entity obtains *control* over the goods (note that the drafting "*obtains the goods*" in ED 2.8 is not sufficiently clear). In most cases, the control over the goods passes at the same time the equity instrument is granted. However, there are cases where the equity instruments may be granted before the entity obtains control over the goods. If equity instruments are granted before the control over the goods passes, and there is a firm contract where the price for the equity instruments to be issued is known and fixed (which information is expected to be available in such circumstances), the fair value of the goods acquired should be based on the fair value of the equity instruments when they are granted.

For the purchase of services, we believe that consideration should be given to whether the entity is entering into a firm contract with a fixed contract price or a fixed rate per unit of output. If so, the fair value of the services received should be based on that fixed price determined at the inception of the contract, which normally reflects a transaction at fair value. This amount should not be adjusted for subsequent changes in the fair value of the services received under the contract (which is what we understand ED 2 would require).

If a service contract does not specify fixed price conditions, we would then agree that it is appropriate to measure the service at its fair value as it is received (hence the fair value of the units of service received may evolve throughout the periods of service).

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?

<u>Note</u>: our response below is subject to our comments on Question 1, i.e. that the proposed Standard does not deal with employee equity-settled share-based payments or, alternatively, that such plans should give rise to equity movements only.

We agree that, if the fair value of share-based transactions is determined based on the fair value of the equity instruments (because the amount is more reliable), generally the fair value should be measured at grant date. We assume that, in most cases, this date falls at the same date when both parties are committed to the transaction (the "commitment date").

However, we note that there are cases where, at the commitment date, the number of equity instruments (e.g. share options) to be issued is not yet fixed because the number will change upon certain conditions being met. If so, we would appreciate guidance from the IASB on how to deal with such situations. Our recommendation is that the entity should make the best estimate at the grant date of the number of equity instruments that will be issued. This number (and the related expense to be recognised) would then be subsequently adjusted depending on how the conditions are met. The adjustment would be accounted for as changes in estimates.

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?

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We disagree with the introduction of 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. We believe that the fair value of goods or services received should be measured based on the amount that is more reliably determinable, whether it is the fair value of the goods or services received or the equity instruments granted. Please see our comments and example at Question 3.

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?

Note: our response below is subject to our comments on Question 1, i.e. that the proposed Standard does not deal with employee equity-settled share-based payments or, alternatively, that such plans should give rise to equity movements only.

We disagree with the requirement that equity-settled transactions with employees should always be measured based on the fair value of the equity instruments granted. We believe that the fair value of the services received should be measured based on the amount that is more reliably determinable. Please see our comments and example at Question 3.

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?

Note: our response below is subject to our comments on Question 1, i.e. that the proposed Standard does not deal with employee equity-settled share-based payments or, alternatively, that such plans should give rise to equity movements only.

We agree that services (and therefore a related expense) should be recognised over the vesting period.

We would appreciate if the IASB could develop guidance to deal with cases where the vesting period is not fixed (e.g. where the vesting conditions do not refer to a specific time period). We propose that an entity should make its best estimate of the period that will be necessary for the vesting conditions to be met, and recognise the service over that period. The entity should revise its estimate subsequently and make adjustments accordingly, to be accounted for as a change in estimates.

Question 9

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

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

Note: our response below is subject to our comments on Question 1, i.e. that the proposed Standard does not deal with employee equity-settled share-based payments or, alternatively, that such plans should give rise to equity movements only.

While we believe that some methodology will be necessary to recognise the fair value of the equity instruments granted over the vesting period, we disagree with the proposed approach in ED 2. The unit of service approach mainly considers a time factor. We believe that other factors should be considered in addition to the time factor, such as the number of share options held by counterparties. One unit of service of a counterparty who holds one share option should not be of equal value to one unit of service of a counterparty who holds say one thousand share options. There may also exist other factors to be considered that are specific to each entity and/or plans.

With respect to the comment above, we understand that ED 2 does not prevent the identification of separate classes of employees to which the proposed methodology could be applied. However, we believe that ED 2's approach is too complex and that more simple methodologies can be applied achieving the same results.

We believe that ED 2's units of service approach could be included as an illustration of how to recognise the fair value of the equity instruments granted over the vesting period but it should not be mandatory. Instead, we recommend that the final Standard lists the key factors to be taken into account for the recognition of the fair value of the equity instruments granted over the vesting period.

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Question 10

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

Note: our response below is subject to our comments on Question 1, i.e. that the proposed Standard does not deal with employee equity-settled share-based payments or, alternatively, that such plans should give rise to equity movements only.

We disagree that no subsequent adjustment should be made to the amounts recognised as an expense in previous periods when it becomes probable that the vesting conditions associated with the performance of a counterparty will not be met. We believe that, instead, a profit should be recognised in the income statement equal to the amount of the expense previously recognised (with a corresponding entry in equity).

Please note that we make a distinction between the various types of vesting conditions that may exist. There are vesting conditions that may purely be associated with the share price and that are out of the control of the counterparty's actions (e.g. vesting conditions that would be based on a set level of the share price). Alternatively, there are vesting conditions that depend on the effective service/performance rendered by the counterparty (e.g. specific targets to be met, etc.).

As we explain at Question 13, we agree with ED 2's approach that whether the vesting conditions will be met should be taken into consideration in determining the fair value of the equity instruments granted.

In addition, when the vesting conditions depend on the effective service/performance rendered by the counterparty, we believe that, if the counterparty does not meet the requested service/performance, then it means that it does not render/have not rendered the service. As a result, no expense should be/have been recognised. An expense should only be recognised when the service is being received, i.e. when it is probable that the counterparty performance conditions will be met.

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?

We agree that market prices should be used, if available, *as a starting point* to determine the fair value of the equity instruments granted. However, this market price will need to be adjusted to reflect the special terms and conditions of the equity instruments granted, which are likely to differ from the terms and conditions of the instruments negotiated on the market (e.g. non-transferability).

We agree that option pricing models should be used to determine the fair value of the equity instruments granted, where the fair value of the equity instruments granted is the more reliably determinable item.

We also agree with the factors to be considered in determining the fair value of options granted using an option pricing model listed in ED 2.20. However, we recommend that the Standard takes account of:

(a) the non-transferability factor but also of the non-negotiability factor; and

(b) the employees' risks concentration factor (from an employee's perspective, the fact that his/her risks are concentrated in the enterprise's shares will affect his/her behaviour and this should be reflected in the measurement of the fair value of the share options). An adjustment will need to be made for this factor either to the volatility factor (since the use of the enterprise's observable market volatility would not be appropriate) or to the fair value obtained from the option-pricing models.

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?

We agree that, in the case of non transferability, an option pricing model considers the expected life of an option rather than its contracted life but it is clear that adjustment alone is not sufficient to take into account the non-transferability. An appropriate model has also to be used.

Question 13

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

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

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

However, we note that it will not be possible to include all types of vesting conditions in an option pricing model, particularly when they relate to the performance of an individual or group of counterparties. In such a case, an adjustment to the value of shares or share options granted obtained from an option pricing model will need to be made, based on the entity's best estimate of the probability that the vesting conditions will be met.

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?

We agree with ED 2's proposed treatment of reload features.

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?

Note: our response below is subject to our comments on Question 1, i.e. that the proposed Standard does not deal with employee equity-settled share-based payments or, alternatively, that such plans should give rise to equity movements only.

As indicated at Question 11, the Standard should address the non-negotiability feature of share options and the employees' risks concentration factor.

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?

We agree with the approach in ED 2.

Question 17

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

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

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Note: our response below is subject to our comments on Question 1, i.e. that the proposed Standard does not deal with employee equity-settled share-based payments or, alternatively, that such plans should give rise to equity movements only.

We disagree with the proposed requirements. We believe that the incremental value should be measured based on the difference between the fair value of the options at the repricing date and the fair value of the options at the grant date.

In most cases, if repricing occurs, it is because the initial instruments granted have lost their value at the date of the repricing and no longer represent an incentive to the counterparty. The repricing transaction occurs to ensure that the initial benefits given will still be given. If, as a result of the repricing, the amount of benefits at the date of repricing is the same as at the initial grant (based on a comparison of the fair values of the options), there is no reason to believe that the "service" to be received from the counterparty has changed or will change. Therefore, only the initially estimated expense for the originally expected "service" should continue to be recognised. If, as a result of the repricing, the amount of benefits at the date of repricing is lower or higher than the amount as at the initial grant (based on a comparison of the fair values of the options), then it is logical to believe that the "service" to be received from the counterparty has changed or will change as well. Therefore, it is appropriate to make an adjustment to the initial estimated expense to be recognised.

Question 18

If an entity cancels a share or option grant during the vesting period (other than a grant cancelled by forfeiture when the vesting conditions are not satisfied), the draft IFRS proposes that the entity should continue to recognise the services rendered by the counterparty in the remainder of the vesting period, as if that grant had not been cancelled. The draft IFRS also proposes requirements for dealing with any payment made on cancellation and/or a grant of replacement options, and for the repurchase of vested equity instruments.

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

We agree with the treatment of repurchase of vested equity instruments and any payment made on cancellation and/or a grant of replacement options.

We disagree with the proposed treatment when an entity cancels a share or option grant during the vesting period. We do not believe that it is appropriate to continue the recognition of an expense over the remaining vesting period, as if the grant had not been cancelled. Instead, the previously recognised expense should be reversed. Our response is consistent with the treatment of equity instruments that ultimately do not vest or share options that are not exercised because the performance vesting conditions are not met. We also believe that the cases where an entity cancels a share or option grant during the vesting period without either a replacement plan or payment will be extremely rare.

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Question 19

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

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

We agree with the proposed treatment for cash-settled share-based payment transactions.

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.

While we do not disagree with the proposed requirements, we want to draw the attention of the Board to the fact that we find the paragraphs dealing with share-based payment transactions with cash alternatives complex to understand. For example, the illustration in the Implementation Guidance was the only way to understand the proposed accounting for shared-based payment transactions in which the counterparty has the choice of settlement.

We also note that the drafting in paragraph 42 differs somehow from the drafting in the proposed revisions to IAS 32, for the classification of derivatives on own shares. For example, ED 2.42 indicates that "*The entity has a present obligation to settle in cash if the choice of settlement in equity instruments is not substantive…*". What does "substantive" mean? We believe that there should be some consistency in terms of drafting between the future revised IAS 32 and the Standard on share-based payments.

Finally, we are unclear about share-based payment transactions with cash alternatives at the choice of the counterparty, where the fair value of one settlement alternative is the same as the other, but statistical data shows that the counterparty will select one alternative more than the other, for example because one alternative has different tax consequences. How should such a situation be handled?

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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)?

We agree with the proposed disclosure requirements, especially as the effective impacts of share-based payments on the shareholders is going to be very different from the proposed treatment. It is important to allow the shareholders to properly restate the actual impact (i.e. the potential/actual dilution effect) which is not going to be visible under ED2.

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 (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.

Equity-settled share-based plans

We are very surprised and disagree with the proposed date for the transitional provisions applicable to equity-settled share-based transactions. We do not know of any standard setter who would include transitional provisions requiring prospective application based on the date of publication of an Exposure Draft. We do not see the reasons for such a change in practice. When transitional provisions require prospective application, the date for prospective application usually matches the effective date of the Standard. We believe that this should be the case for the treatment of all equity-settled share-based plans under the future Standard.

We would also appreciate if the Board could clarify the treatment of a repricing that occurs after the date on which prospective application starts, for a plan that was issued before that date: should it be treated as a repricing or issuance of a new plan?

Cash-settled share-based plans

We have difficulty understanding the purpose of the transitional provisions and the reason why a measurement at a settlement amount would be permitted. Firstly, it would be appropriate to explain what is the difference between measurement at fair value and at settlement amount. Is settlement amount intrinsic value? If so, if a cash-settled share-based plan is measured at settlement amount on transition, is an adjustment immediately after the transition required to measure the plan at fair value?

Question 23

The draft IFRS proposes a consequential amendment to IAS 12 (revised 2000) Income Taxes to add an example to that standard illustrating how to account for the tax effects of share-based payment transactions. As shown in that example, it is proposed that all tax effects of share-based payment transactions should be recognised in the income statement.

Are the proposed requirements appropriate?

We agree with the accounting for the tax effects of share-based payment transactions.

Question 24

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

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

- **employee share purchase plans are excluded from SFAS 123, provided specified criteria are met, such as the discount given to employees is relatively small;**
- **SFAS 123 encourages, but does not require, entities to apply its fair value measurement method to recognise transactions with employees; entities are permitted to apply instead the intrinsic value measurement method in**

Accounting Principles Board Opinion No. 25 Accounting for Stock Issued to Employees (paragraphs BC70-BC74 in the Basis for Conclusions give an explanation of intrinsic value); and

- **unlisted (non-public) entities are permitted to apply the minimum value method when estimating the value of share options, which excludes from the valuation the effects of expected share price volatility (paragraphs BC75-BC78 in the Basis for Conclusions give an explanation of minimum value).**

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

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

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

(d) SFAS 123 does not specify a measurement date for transactions with parties other than employees that are measured at the fair value of the equity instruments issued. Emerging Issues Task Force Issue 96-18 Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services requires the fair

value of the equity instruments issued to be measured at the earlier of (i) the date a performance commitment is reached or (ii) the date performance is complete. This date might be later than grant date, for example, if there is no performance commitment at grant date. Under the draft IFRS, the fair value of the equity instruments granted is measured at grant date in all cases.

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

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

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

We support convergence of US GAAP and IFRS towards a common solution on the topic of share-based payments. We have indicated above those areas where we consider that ED 2 needs to be changed so that it becomes an acceptable solution.

We believe that as long as the FASB and the IASB have not come up with a solution that would be applicable at the same time to both US companies and IFRS issuers, the IASB should not issue a Standard on share-based payments. We believe that it would put IFRS issuers at a competitive disadvantage with US companies.

Question 25

Do you have any other comments on the Exposure Draft?

The Standard does not address the issue of hedges of share-based payment plans. We understand that if such hedging strategies were implemented from an economic perspective, they could not qualify as hedge relationships under IAS 39 and they would result in a lack of symmetrical treatment in the income statement. We believe that this is a matter of concern that should be addressed by the Board.