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Our ref RB - IASBresponse

Your ref ED 2-Share Based Payment

6 March 2003

Dear Sir/Madam,

CL 55

ED 2 Share-Based Payment

We welcome the opportunity to comment on the Exposure Draft 2 - Share-based payment.

We support the objective of the proposed standard to recognise an expense when the goods or services received or acquired under a share-based payment transaction are consumed. However there are several areas where we believe further consideration of the Board is required.

These points are summarised below and the detailed answers to the questions are set out in the attached Appendix A. We have only set out answers where we believe changes may be required to the proposals or we seek further clarification. We have included within these comments our response to the questions that the Accounting Standards Board in the UK have raised to provide a complete list of our concerns on the proposed standard.

1. Under the current proposal in paragraph 8, the fair value of the goods or services received in an equity settled share-based payment transaction should be measured at the delivery date when applying the direct measurement method.
Consequently depending on whether the fair value of the goods received is measured directly or not, the draft standard prescribes that measurement shall be done at either delivery date or grant date respectively. We do not believe that this is appropriate and believe that measurement should consistently be at grant date. This is consistent with the treatment of most executory contracts.

2. We consider that the minimum disclosure requirements as set out in paragraphs 46, 48 and 53 are burdensome for the preparers and might obscure the key messages to the users of financial statements. They should therefore be illustrative of the sort of disclosure needed to meet the requirements set out in

the bold paragraphs and included in the Appendix and not the main standard. The appendix should also make it clear that some of the disclosures may be made in tabular form rather than as illustrated.

3. There are some issues for group companies where both the parent and the subsidiary may be accounting for the same transaction and we consider that the standard has not given sufficient consideration to some of the issues that arise. This will be of significance to many UK plc's with a wide employee base who have encouraged share participation through SAYE schemes.

4. We also consider that it may be helpful to some preparers to have the option, on implementation of the standard, to apply it to all grants that have not yet vested. Disclosure would be required as to whether this option had been taken up or not.

If you have any questions arising out of our more detailed comments please do not hesitate to contact us.

Yours sincerely

Roz Ball
Financial Controls Manager

APPENDIX A

ASB Question 1

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

Our comments:

We do not generally agree with the approach of the ASB of adopting the substance of IFRS into UK standards before January 2005 on the basis that this does not provide comparability year on year. We believe that this could potentially lead to the accounting policies changing each year with either prior year adjustments or reclassifications and considerable effort being required to inform investors of the impact and the underlying trading performance. We believe in the interests of both comparability and also understanding the impact of the change, on adoption of IFRS, it is better to move to IFRS as one change.

However, since this particular area of accounting is not currently adequately covered by UK standards we see no reason to object to the proposed implementation date.

ASB Question 2

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

Our comments:

We are concerned that the Boards have not fully considered all the implications of this approach.

1. Application to groups of companies

It is unclear what treatment would be adopted in the books of the company granting options, where some of the recipients are employed by the granting company and some by its subsidiary undertakings. In particular:

- *Does the grant of options to an employee of a subsidiary represent a receipt of services by the granting company? If it does, then the consolidated profit and loss account of the group would have a double charge in respect of options granted to subsidiary company employees, unless eliminated by a consolidation adjustment.*
- *When determining the probabilities of employees leaving, or performance criteria being met, should these probabilities be determined for the group as a whole, or calculated separately for each subsidiary? If the former, there is a risk that the experience profiles for individual companies are so different that use of an averaged set of assumptions would produce an inappropriate result*
- *In the case of UK companies, if the cost of options were charged in both parent and subsidiary, this would mean that distributable reserves were charged twice for subsidiary employees. This would represent an artifical restriction on the ability of the group to distribute profits to its shareholders.*

To avoid these issues, we believe that the following amendments should be made to the proposed standard:

- *Where a company grants options to its own employees and to employees of subsidiaries, its own profit and loss account should only be charged for options granted to its own employees, and subsidiaries should charge the cost of options granted to their employees in their own profit and loss accounts. There would then be no need for consolidation adjustments, and no double charge to distributable reserves.*

- *In calculating the charge for options granted, an entity should give due consideration to whether the probabilities of employees leaving and performance criteria being met are similar throughout the group. If there are significant differences in probability, these should be determined on an entity by entity basis, rather than using an averaged group assumption.*

- *The ASB should consider how the charges for options should be accounted for within reserves. In particular, when an option is exercised, what are the appropriate entries, if any, in the share premium account and retained profit account? In addition guidance is required on whether a charge to the profit and loss account in respect of the grant of options under an equity-settled scheme results in a diminution of distributable reserves.*

2. Grants in relation to unlisted entities

The standard as drafted applies to both listed and unlisted entities. However in the case of an unlisted entity, determining the information required to populate an option pricing model will involve a high degree of estimation based on essentially subjective criteria.

Whilst this can be disclosed within the accounts we doubt that the considerable effort and disclosure that would be required would result in a meaningful charge being reflected in the accounts.

We therefore consider that grants of equity-settled options within unlisted companies should be exempt from the accounting provisions of the standard and this fact should be disclosed within the accounts. However the disclosure requirements should still apply.

Whilst this approach might result in some practical difficulties in drafting a prospectus or five year summary for unlisted companies which subsequently float, we consider that this matter could be more effectively dealt with via the listing requirements of the stock exchange concerned.

ASB Question 3

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

Our comments:

Conceptually there should be no difference between a SAYE and an Executive type option scheme. From a practical perspective in view of the potential cost to the profit and loss account and the perceived importance of EPS in the financial markets it is likely that the current discount to market on such schemes is likely to reduce considerably.

However the fact that this might change policy on such schemes should not impact on the accounting, which is to recognise the "cost" to shareholders of such grants.

ASB Question 4

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

Our comments:

See answer to ASB Question 2.

We consider that the ASB needs to consider some of these issues in the UK context particularly because of the current UK law in relation to distributions. We believe that the ASB should be giving additional guidance on the application of the standard in the UK context.

ASB Question 5

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

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

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

Our comments:

The accounting for ESOP plans will need to be covered by some element of UK standard or abstract to ensure that the shares owned by the trust and any other liabilities or cash are appropriately accounted for within the consolidated accounts. The removal of UITF 13 (and potential cancellation of FRS 5) could potentially lead to the non-consolidation of such entities.

The area of directors' emoluments continues to be a particular focus of readers of accounts. Since directors may form part of a wider group of senior management employees, entitled to options in the same terms as other individuals, the reader may not be able to understand from the one line charge for share-based payments an appreciation of the quantum of options that have been awarded to the directors.

It would probably be therefore useful to leave disclosure of the amount of options outstanding at the year end (and comparative) and a weighted average option price together with any movements in the year. Not all of this information would be required under the current Companies Act, although this information is required for listed companies.

ASB Question 6

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

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

Our comments:

It would be useful if some element of full retrospection was allowed. There will potentially be a build up in the charge over a 2-3 year period as many companies make grants each year. Therefore, whilst the annual profit and loss charge will reflect this going forward, there will be no complete comparative in the early periods following implementation of the standard.

It may therefore be appropriate to allow full retrospective adoption for options granted but not yet vested, with disclosure of whether this option has been exercised or not. Some companies may have difficulties in obtaining the information to calculate the charge and therefore are not able to apply this retrospectively.

We therefore consider that it would be useful if this option was allowed, with disclosure of whether the option to account retrospectively has been taken or not.

IASB 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?

Our comments:

We agree with the IASB proposal for the reasons given in the Basis for conclusions with the following exception. We consider that for unlisted companies there may be considerable practical difficulties in determining the value of the option.

We therefore believe that unlisted entities should be allowed to be exempt if they consider that the level of work involved to do the estimation is impractical. This fact should be disclosed and detailed disclosures of the grant should still be made.

IASB 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?

Our comments:

The date at which the fair value should be measured should be consistent. It should be at grant (contract) date. On this date the two parties contractually agree the value of the goods or services to be provided. This would be consistent with the measurement of other executory contracts.

We therefore ask the Board to reconsider the wording of paragraph 8 and the arguments supporting the conclusion.

IASB 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?

Our comments:

We consider that grant date is the most appropriate date as the existence of the obligation to grant the shares is created on that date. Since in most instances, there is then a period of time over which the "services are provided" to allow entitlement, a value needs to be determined by which those services are measured.

Whilst it would be possible to use an estimate of the value at vesting date, since the employee is aware that the reward will be the differential between the grant price and the market price on date of vesting/exercise, when the obligation is created the potential value *is not yet known. The services should therefore be measured based on the price at grant date, as this is the date the obligation is created.*

IASB 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 not so?

Our comments:

We would recommend that the Board review the requirement to always measure the fair value of the employee services received by reference to the fair value of the equity instruments as too restrictive. There will be occasions when an entity will look at the total remuneration package of an employee and after deduction of other cash remuneration and benefits in kind the balance is awarded as a share option grant.

In such instances the fair value of the services is known, as it is part of a structured package. There should therefore, be a rebuttable presumption that the fair value of the equity instruments is more readily determinable than the fair value of the employee services received or receivable.

Also in many cases where a subsidiary's employees have been granted options in a parent there may be a charge from the parent for these options and this is more readily determinable.

IASB Question 8

Paragraphs 13 and 14 of the draft IFRS propose requirements for determining when the counter party renders service for the equity instruments granted, based on whether the counter party 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 counter party as consideration for the equity instruments are received during the vesting period? If not, when are the services received, in your view?

Our comments:

No. We believe it is not always appropriate to presume that the services rendered by the counter party as consideration for the equity instruments are received during the vesting period.

In some instances a grant for past performance will have future vesting conditions (such as employment for the next three years). It may be appropriate therefore to apportion the grant between its various components i.e. past and future service.

The standard should therefore include consideration of whether the services have been substantially received or not. If the vesting depends solely on future performance then it is reasonable to presume that the services rendered by the employee/counter party are received during the vesting period.

IASB 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?

Our comments:

There is an argument that it is not necessary to attribute an amount to each unit of service received. The danger is that there may be a difference between the number of options granted to individuals and therefore by applying a standard value per unit of service received this may incorrectly attribute value to an individual's period of service if it has no reference to the number of options they hold.

The current proposal set out in Appendix B Example 1 would indicate a different approach to that envisaged under a cash-settled equity based transaction. There should be no *inherent difference in the logic used to address both areas. The value of the option should not change only the number of options that are being charged through the profit and loss.*

The cash-based settlement is trued up each year and we cannot identify the logic between using two different methods – i.e. one trued up and one not trued solely because the credit item sits in a different position in the balance sheet.

We consider that the EFRAG proposed alternative method set out in its draft comment letter on ED 2 is the more appropriate method of calculating the charge. This does not adjust the value of the option only the quantum of options that are being accounted for.

It also has the additional advantage of being considerably simpler for an entity to track the relevant information. Companies would have to obtain considerable information from their payroll systems in order to calculate the charge as currently envisaged.

IASB Question 10

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

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

Our comments:

The main area where we consider this to be inappropriate is in relation to the achievement of performance targets inherent within a share option plan. The nature of the plan is operating in the same manner as a cash bonus scheme in that there is no reward for failure to achieve the targets. We cannot see that the behaviour of an individual in relation to a cash-based bonus scheme and a share-based scheme would be any different.

The current ED will cause a difference between the charge for a "cash-based" settlement where the liability will be reviewed each year both in terms of value and provision size, therefore adjusting for the probability of vesting and the share-based plan. Failure to meet *targets will not result in a credit to the profit and loss of amounts transferred in previous years only a transfer on reserves for share-based payment schemes.*

To the extent that the vesting conditions are therefore effectively setting a bonus target, failure to meet those vesting conditions should be treated in the same as a cash-based scheme or annual bonus i.e. provision is made each year dependent on the rules of the scheme and the amount likely to be paid.

This does not necessarily mean that in the case of a share-based payment that the value of the option has been adjusted. It will have been amended solely for the number of options that can vest.

There should be no intrinsic difference between the method of estimating the costs of what are effectively long term bonuses. Any other estimate of long term costs looks to charge each year, so as to ensure that the amount provided at the balance sheet is the amount that is likely to be paid taking into account the level of service received.

If the provision is overstated at any point then the excess is released to profit through the profit and loss account, as the estimate has changed not the basis for the accounting, because more information is available. Logically a share-based payment, which is settled in equity, should not be accounted for on a different basis.

The value of the equity is not necessarily being adjusted, only the assumptions, which indicate how many options would be granted. Non-exercise of options should not lead to truing up as this is a decision of the shareholder but adjustments should be made for earlier vesting estimates.

IASB 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?

Our comments:

We agree that the vesting conditions should affect the expense recognised. However we believe is logically better to adjust the value produced by such a model and reflect the appropriate charge in the profit and loss during the period of vesting.

When vesting conditions comprise performance conditions we believe that the determination of the adjustment can be very arbitrary, particularly if these are linked to performance against some industry index. The charge should therefore be trued up each year in relation to the impact of the vesting conditions.

IASB Question 17

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

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

Our comments:

We consider that an entity should measure the incremental value granted upon repricing and include that incremental value when measuring the services received during the remaining of the vesting period.

We consider that the alternative method illustrated in example 3 of Appendix B as the most appropriate method. This method better matches the total expense of the service received with the period in which it is received. The alternative method reflects the fact that a re-pricing took place instead of assuming that the original grant is in place.

Furthermore, the calculation of the incremental charge should be modified to take into account the weighted average probability that the employees will complete the required service period.

IASB 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 counter party 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.

Our comments:

We consider it a little odd to be required to continue to account for a transaction that no longer exists. In practice it is unlikely that an option would be cancelled without some compensation to the counter party either in the form of cash or replacement of options.

It is possible that no payment might occur where an option is so far "underwater" that it is worthless. It is likely that, in such circumstances, that the vesting conditions would not be capable of being met and on the basis of truing up, no charge should be made as we have argued above

IASB 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)?

Our comments:

We support the disclosure principles set out in paragraphs 45, 47 and 51. However we consider the minimum disclosure details requirements set out in detail, particularly in paragraph 48 as excessive. The object of the disclosure should not be to enable the reader to check the calculation of the number but to understand the factors to which the estimated amounts are most sensitive.

The Board should therefore make it clear that Appendix D gives an idea of the potential disclosures under the IFRS, but should not be considered as prescriptive and the use of tables in comparing estimates used to actuals in the year should not be ruled out. In most companies there will be a number of grants made under various schemes at different prices and to provide the level of information set out in these paragraphs, where more than one grant might be exercised in a year, could be very cumbersome. We consider it appropriate that the requirements of paragraph 48 should be included in the Appendix and not the main body of the standard

IASB 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 counter party 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.

Our comments:

We consider that entities should be given the option to apply this retrospectively to grants that were made before the issue of the draft standard and have not vested at implementation date. The entity would need to disclose whether it had exercised this option.

IASB 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.

Our comments:

We believe that the IASB proposed treatment is not more appropriate in the case of points (b) and (c) discussed above.

In respect of (b) we refer to our responses to questions 9, 10 and 13.

In the case of (c) we believe that if an entity settles in cash a grant of equity instruments during the vesting period, the SFAS 123 accounting is preferable to the IASB proposal.

We believe that the cash payment represents an accelerated vesting and if vested then the entity should presume that the services to be rendered as consideration have been received. An adjustment should therefore be made for the unrecognised compensation expense. This adjustment should be determined as the total expected units of service (at grant date) minus the actual units of service received, multiplied by the fair value if the unit of service.

IASB Question 25

Do you have any other comments on the Exposure Draft?

The Appendix would be enhanced if the Boards included a simple but complete example of all the different accounting entries required at the different stages during the life of a share option grant.

It would be useful if the simple example was expanded to deal with the issue of a grant by a parent to a subsidiary's employees.

In the UK this could then be amplified to indicate the area of the statements of equity that some of these items should be included in, particularly in the light of current UK law.

We believe that the UK draft standard is currently lacking in providing guidance on the specific application in a UK reporting environment. Guidance on the impact on distributable reserves would be particularly useful.