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ANSWER TO
« ED2 SHARE BASED PAYMENTS"

General overview of Acteo's position

We are not in favour of the draft IFRS dealing with share-based payments in relation to option plans.

A large number of our members continue to argue that no expense has to be recognised and are not convinced by the arguments presented in that respect in the Exposure-draft or Basis for Conclusions.

However, far beyond the debate whether conceptually an expense should be recognised, we cannot support this draft IFRS because, in our view, the Board does not achieve the objective that is set out in the introduction, that is to ensure that entities provide high-quality, transparent and comparable information to users. As is explained below:

- Measurement requirements do not provide a reliable, transparent and comparable information:
  - designing option value as a surrogate measure of services rendered is purely conventional,
  - valuing options using option pricing models cannot be ascertained as reliable,
  - option pricing may, under certain circumstances, yield inconsistent valuations
  - valuations of options is a matter for specialists and are heavily dependable on assumptions used; therefore valuations obtained are not accessible to an ordinary user of financial statements.
- Measurement requirements are not consistent with the draft standard internal logic, which is that an expense is recognised because a service is received.

Moreover, observing that accounting principles and practices in the United States evolve is not sufficient to ensure that convergence will indeed be achieved. European companies insist on the necessity for a level playing field.

Finally, conclusions reached as to employee share purchase plans are erroneous.

Measurement requirements do not provide a reliable, transparent and comparable information:

1) *Designing option value as a surrogate measure of services rendered by employees is purely conventional*

Such a designation relies on the assumption that the fair values of the services expected to be rendered and of the unvested options are equal. However since no party gives anything away in the exchange that occurs, this assumption, contrarily to transactions involving an exchange of assets, does not need to verify to make the deal good to both parties.

Nonetheless, the fair value of the consideration given in exchange for services rendered by employees would be an appropriate surrogate measure, provided it were a reliable measurement of the services obtained, that is a measurement comparable from entity to entity. Obviously, comparability cannot be obtained. There is indeed no correlation between the value of services rendered and the value of options or the market price of the underlying shares.:

- there is no correlation whatsoever between the volatility of company shares and the quantity and quality of services rendered; even though services were alike from a company to the other, the measurement thereof would vary greatly, because option pricing is very sensitive to volatility;

- within the same company, option pricing varies greatly, from day to day, following the variations in the market price of the underlying shares. Hence the same services would be valued differently, depending on the share market value on grant date. So volatile a valuation cannot be retained as a sound measurement of services.

Therefore the indirect method does not provide a reliable measurement of services rendered. Reliability and comparability are hence denied.

We therefore believe that the Board is misleading users in making them believe that the expense to be recognised will effectively reflect the services rendered, and that thanks to the publication of the new standard, they will be in a position to reliably compare a company that pays salaries in cash with a company that pays a mix of salaries in cash and of options. Because users will not.

Would such an indirect measurement be applied, there is a need to present it for what it really is, that is a pure conventional measurement, without any link with the underlying reality. The Board should not pretend that the valuation techniques involved reliably reflect the expense that would have been incurred, would the services have been paid in cash.

2) Valuing options using option pricing models cannot be ascertained as reliable.

The available pricing models are relevant for traded options because liquidity is a basic assumption in their logic. When applied to illiquid markets, the logic is torn.

Nonetheless, option models are commonly used by traders on financial markets where liquidity is reduced. In those cases, as this draft standard suggests that should be done, the measures obtained are adjusted in order to take the reduced liquidity factor into account. There is however no theory on how to perform such adjustments and traders do constitute their own experience in adjusting the values obtained. They are enabled of building up such an experience because at some point in time they are able to buy or sell and hence grasp market measurements regularly.

In valuing stock options according to the requirements included in the present draft, the validity of the valuations obtained are even more critical:

- there is no liquidity for options, whatsoever,
- there will hence never be any market or settlement value to validate the valuations obtained.

We have already established that retaining the valuation of options as measurement for services rendered could be only conventional. It is even more so when we are faced with a pricing of options of which reliability cannot be established.

3) Option pricing may, under certain circumstances, yield inconsistent valuations.
Moreover and according to the actuaries who have assisted us in assessing the present draft, those models do not yield results contained in an acceptable range in all situations. Apparently, those models may be used in companies which have been listed and have granted options to their employees for a long time. They are not reliable at all otherwise, that is for unlisted or recently listed companies.

4) Valuations of options is a matter for specialists and are heavily dependable on assumptions used; therefore valuations obtained are not accessible to an ordinary user of financial statements.
Also, every time a pricing model is used, the valuation obtained is very sensitive to the relevancy of the inputs to the model. As the disclosure requirement reflect, there are very detailed information to be analysed in order to assess how valuations have been carried out. The information is accessible and might be transparent to specialists. It is not to ordinary users of financial statements.

Measurement requirements are not consistent with the draft standard internal logic, which is that an expense is recognised because a service is received.

The whole standard is based on valuing services rendered: it however ignores situations in which services may decrease or cease to be rendered.
Would the measurement be a proper reflection of the service rendered, we could agree with the Board that a proper valuation is reached at grant date, because that is when the company decides of the specifics (exercise price and time, vesting conditions). Those specifics reflect, at that time, conditions in which an option plan may be motivating and out of which the company may hence expect services.
The draft IFRS however ignores that companies will obtain services all over the vesting period only if the plan increases, or at least maintains, its appeal for employees. We therefore disagree that the valuation of the expense be determined, once and for all, at grant date. Even more so when the company acknowledges that the plan no longer is efficient, upon cancellation or repricing.

Observing that accounting principles and practices in the United States evolve is not sufficient to ensure that convergence will indeed be achieved.

We understand that, in the convergence area, one has to be first if the others are to follow. We understand also that the IASB intends to be the first standard setter to impose accounting for an expense in relation to share-based payments.
In order to ensure that competition is fair throughout financial markets worldwide, we recommend that, should the IASB issue a new standard before present accounting standards are amended in the United States, the requirements included in that standard be not mandatory before convergence is achieved. Strict convergence is all the more necessary that the draft standard relies on a conventional valuation.

Conclusions on employee share purchase plans are inappropriate.

Employee savings schemes have developed throughout Europe that provide access to the company's equity, in conditions that are comparable to other ordinary increases in equity.
Therefore there should be criteria set out to allow for proper assessment of the applicability or non-applicability of the draft standard to those schemes. According to the basis of conclusions, the issue seems to be addressed, appears overlooked and therefore does not drive to adequate conclusions. For the reasons and in the conditions expressed in detail in our answer to question 1, we conclude that most of employee share purchase plans will naturally fall out of scope of the draft standard.

Because the Board has not yet succeeded in defining an adequate measurement requirement that would lead to comparable information in all circumstances, we strongly recommend that expense recognition be abandoned, until such time when means to obtain a reliable valuation of services rendered are available. With such a decision, the Board would be consistent with both the framework (measurability is a condition to recognition) and paragraphs 95 and following in IAS 39 that specify that whenever fair value models do not provide with estimates within an acceptable range, disclosures are preferable to recognition.

Would the Board insist on issuing requirements similar to those included in the present draft, we advise that the services rendered be valued, on a conventional basis, at the minimum value of the options granted. Minimum value would indeed, in our opinion, be the measurement the least harmful to comparability.

QUESTIONS

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 Board conclusions reached regarding employee share purchase plans, as detailed in BC 8 to BC 15.
Employee share purchase plans may take various forms, and the Board needs to develop criteria in order to allow proper analysis of the substance of the transaction that the entity and its employees enter into.
Proper analysis must provide the answer to the two following questions:

- does the plan grant free options?
- does the discount granted feature an employee benefit?

According to the Basis for conclusions and more particularly to BC 13, it seems that the Board has addressed the issue and overlooked the consequences. Conclusions such as "in such situations, the rights given to the employees under the plan probably do not have a significant value" avoid the issue and base a decision on a mere assumption that has not been ascertained. As such they should be rejected and the analysis be carried out as done below.

Whether free options are granted

Employee share purchase plans in France have substantially no option feature. Employees are provided with an opportunity to buy a specific number of shares at a discounted price. For obvious communication and administrative needs, the entity has to define a span of time during which the opportunity of buying shares is open (once the decision is made, the details of the plan have to be explained to employees, employees that want to become shareholders need to make savings available, time for paperwork is needed…). The span of time involved does not feature an exercise period. Ordinary increases in equity do also require such spans of time.
We can therefore derive from the observation of the market that an employee share purchase plan has substantially no option feature when the period between the opening and the closing of the operation is similar to the span of time involved in ordinary increases in equity.

Whether the discount granted features an employee benefit

The discount granted would feature an employee benefit if and only if it exceeded the discount that would be granted to another potential investor placed in similar conditions.
The discount granted in employee share purchase plans must account for:

- the discount offered in ordinary increases in equity in the same period and location,
- the constraint born by the employee to remain a shareholder for at least a given number of years (from what we have seen, and depending on local regulations, the number of years vary from three to five years).

We can derive therefrom that a discount no higher than the double of the discount offered in ordinary increases in equity in the same period and location does not feature an employee benefit.

Therefore we recommend the Board:

- to acknowledge the reality of employee share purchase plans that do feature neither options nor employee benefits,
- to determine that whenever a share purchase plan:
  - ✓ does not involve a subscription period longer than ordinary increases in equity in the same period and location, or,
  - ✓ does not involve discounts higher than the double of the discount offered in ordinary increases in equity in the same period and location, and,
  - ✓ does not include any vesting conditions,

  the plan does not fit the scope of the standard.

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 ?

These requirements generate measurement issues that are detailed in the answers to the questions below.

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?

We agree that the entity should measure the goods or services received and the corresponding increase in equity, directly, at the fair value of the goods or services received, in all instances when there is an appropriate measure of that fair value (see our answer above). However, the fair value of the options granted cannot be considered as a reliable surrogate measure.

This requirement is based on the assumption that, as in every other exchange of assets, the fair values of the assets exchanged are equal. This assumption is, in our opinion, erroneous when applied to employee stock option plans. When unvested options are granted to an employee, the employee and the entity do exchange hopes: the hope of an increased added value for the entity, the hope of a potential financial gain for the employee. As no party in the transaction gives anything away, and that at worst there will be neither any gain nor any loss for anyone, there is no need for equal values to make the deal good to both parties.

One objective of the standard is to increase comparability between entities, whether they pay their goods and services with cash or with equity-settled instruments. Consequently, the fair value of the consideration given in exchange for goods and services would be an appropriate surrogate measure, provided it were a reliable measurement of the goods and services obtained, that is a measurement comparable from entity to entity. Obviously, comparability cannot be obtained:

- there is no correlation whatsoever between the volatility of company shares and the quantity and quality of services rendered; even though services were alike from a company to the other, the measurement thereof would vary greatly, because option pricing is very sensitive to volatility;
- within the same company, option pricing varies greatly, from day to day, following the variations in the market price of the underlying shares. Hence the same services would be valued differently, depending on the share market value on grant date. So volatile a valuation cannot be retained as a sound measurement of services.

Would such an indirect measurement be applied, there is a need to present it for what it really is, that is a pure conventional measurement, without any link with the underlying reality.

Furthermore, it is necessary to ensure that the fair value of the consideration given can be reliably measured. According to the actuaries who have assisted us in assessing the present draft, those models can be used in companies which have been listed and have granted options to their employees for a long time. In those cases, they yield values that vary in an acceptable range, since relevant data inputs are available. They are not reliable at all otherwise. The actuaries that we have met unanimously deny that option pricing models can be applied to unlisted or recently listed companies, if the valuation obtained requires the least bit of consistency.

Question 4

If the fair value of the goods or services received in an equity-settled share-based payment transaction is measured directly, the draft IFRS proposes that fair value should be measured at the date when the entity obtains the goods or receives the services (paragraph 8).
Do you agree that this is the appropriate date at which to measure the fair value of the goods or services received? If not, at which date should the fair value of the goods or services received be measured? Why?

No, we do not agree. In an ordinary transaction, that is a transaction that includes a consideration in cash, the expense is accounted for at the price agreed between the entity and the supplier prior to the delivery of goods or the rendering of services. That price may reflect, depending on the agreement set out between parties, either market conditions at the time of the order, or market conditions at the time of delivery. Consequently, in share-based payment transactions, both options, that is measuring the fair value of goods or services obtained either at grant date or at delivery/ rendering date, are acceptable.
However, since equity-settled share based payment transactions may, in certain cases, be measured indirectly, we recommend that both the direct and indirect measures be made at grant date, for consistency purposes.

Question 5

If the fair value of the goods or services received in an equity-settled share-based payment transaction is measured by reference to the fair value of the equity instruments granted, the draft IFRS proposes that the fair value of the equity instruments granted should be measured at grant date (paragraph 8).
Do you agree that this is the appropriate date at which to measure the fair value of the equity instruments granted? If not, at which date should the fair value of the equity instruments granted be measured? Why?

Yes, we agree that grant date be retained, for the reasons expressed in § BC 90.

Question 6

For equity-settled transactions with parties other than employees, the draft IFRS proposes a rebuttable presumption that the fair value of the goods or services received is more readily determinable than the fair value of the equity instruments granted (paragraphs 9 and 10).
Do you agree that the fair value of the goods or services received is usually more readily determinable than the fair value of the equity instruments granted? In what circumstances is this not so?

Yes, we agree that the fair value of goods and services received from parties other than employees can be presumed to be more readily determinable than the fair value of the equity instruments granted.

Question 7

For equity-settled transactions with employees, the draft IFRS proposes that the entity should measure the fair value of the employee services received by reference to the fair value of the equity instruments granted, because the latter fair value is more readily determinable (paragraphs 11 and 12).
Do you agree that the fair value of the equity instruments granted is more readily determinable than the fair value of the employee services received? Are there any circumstances in which this is not so?

We agree that, in most cases, the fair value of the equity instruments granted is more readily determinable than the fair value of the employee services. This is generally the case when the salary package granted to the employee is, beyond the grant of options, material and comparable to salaries granted by other entities.
In some circumstances, however, the fair value of services granted may be more readily determinable. This is the case when the grant of options is meant to be the most material part of the salary package, and when the salary paid in cash is not comparable to salaries ordinarily offered by entities to employees meeting the same level of qualifications and background. Moreover, entities offering such salary packages are most often the entities in which the fair value of equity instruments granted cannot be determined reliably. In those cases, measuring directly the services received may be the only reliable valuation available.
We therefore recommend that the final IFRS include a rebuttable presumption that, for equity settled transactions with employees, the fair value of the equity instruments granted are more readily determinable. Entities should not be prevented from justifying and valuing differently from that presumption.

Question 8

Paragraphs 13 and 14 of the draft IFRS propose requirements for determining when the counterparty renders service for the equity instruments granted, based on whether the counterparty is required to complete a specified period of service before the equity instruments vest.
Do you agree that it is reasonable to presume that the services rendered by the counterparty as consideration for the equity instruments are received during the vesting period? If not, when are the services received, in your view?

Yes, we agree, even though there may be a link between the number of options granted and the employee performance in the past. A lot of stock option plans do not include any discount feature and the strike price is equal to the market price at grant date. Stock options are hence mainly designed to generate future value, both to the shareholders through the valuation of their investment and to the employees through the building up of a gain upon resale. The existence of vesting conditions reflects that the entity awaits in the future a counterpart from the employee.

Moreover, as we have already explained, this measurement is purely conventional and cannot be expected to reflect reality. Leaving the door open to a complicate mixture of past and future performance can only lead to a free determination of the level of expense that hits the income of the period.

Question 9

If the services received are measured by using the fair value of the equity instruments granted as a surrogate measure, the draft IFRS proposes that the entity should determine the amount to attribute to each unit of service received, by dividing the fair value of the equity instruments granted by the number of units of service expected to be received during the vesting period (paragraph 15).
Do you agree that if the fair value of the equity instruments granted is used as a surrogate measure of the fair value of the services received, it is necessary to determine the amount to attribute to each unit of service received? If not, what alternative approach do you propose? If an entity is required to determine the amount to attribute to each unit of service received, do you agree that this should be calculated by dividing the fair value of the equity instruments granted by the number of units of services expected to be received during the vesting period? If not, what alternative method do you propose?

Basically, yes, we agree in principle. However, two adjustments need to be made to the method retained in the draft standard, to increase consistency with the underlying principle.

Firstly, we do not believe that the unit of service should remain unchanged whatever the circumstances are. We agree with the Board that options should be valued at grant date (see our answer to question 5). Shareholders, or management on their behalf, agree to stock option plans since they believe that granting options to employees is a means of associating them to the increase in the value of their investment, and that the expected increase will more than compensate the dilutive effect of the plan. Increases in the underlying share market price are therefore the sign that the stock option plan is yielding the expected results, that is that employees are rendering the services expected from them at grant date. Therefore we agree with the Board that the unit of service determined at grant date is relevant when the share market price increases.

When the share market price decreases is however another story. In those cases things are not happening as they were expected, and the valuation of the unit of service should not remain unchanged. When the share market price decreases, there is a loss of efficiency in the plan, and it would be wrong to consider that services can be obtained when the expectable consideration does not build up as was anticipated.
We therefore recommend that, at each balance sheet date, the option pricing carried out at grant date be rerun, with all parameters unchanged except for the market price of the underlying shares. Any decrease of the valuation obtained should be reflected in the unit of service, proportionally. Doing so would reflect the loss of efficiency in the plan, and be consistent with the logic of the conventional measurement that the draft standard proposes.
Secondly, as a clarification, we believe that examples set out in Appendix B should be modified and take as assumptions a case when different categories of employees are granted different numbers of options. This would make it clear, as it is logical, that the expense should reflect the number of options not yet forfeited, not the number of beneficiaries not yet forfeited. It would also have the advantage of being closer to real life.

We note that the method of valuation of the unit of service as defined by the IASB differs from the method of valuation retained in FAS 123. We believe that the valuation method defined by the IASB is superior. However, as convergence is a main issue, even more so in the context of such a conventional measurement, we recommend that the Board retain the same valuation method as in FAS 123, if it were the price of achieving convergence.

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?

Yes, we agree.

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?

In order to address the measurement issue in that draft IFRS, we asked several actuaries working for either companies or audit firms, to explain how pricing models worked and where and when they could be considered consistent. As expressed in our answer to question 3, option pricing models should not be used for unlisted companies (or recently listed companies, if expected volatility has to be determined), since there is no way to ensure reliable and/or consistent inputs to models. Option value could vary in too wide a range to be consistent.

Furthermore, including volatility as an input parameter to the model puts too much emphasis on what the ultimate gain might be for the beneficiary, whereas the objective is to yield a measurement, as consistent as possible with, if not the value of, the rendering of services by the employee (on this issue please refer to our answer to question 3 also). Excluding volatility means to retain the minimum value as measurement basis, which in our opinion would be the measurement the least harmful to comparability.

Would the Board insist in taking some kind of volatility into account (considering as it is stated in the basis of conclusions that consideration given would otherwise be underestimated), then we recommend that the valuation obtained be adjusted to correct the discrepancies that volatility generates among entities.

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?

According to the actuaries that assisted us, switching from contractual life to expected life is consistent with employee attitudes towards options that are not transferable.

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 estimating the fair value of options or shares granted.
According to the actuaries who assisted us:

- vesting conditions can be integrated into the model if they relate to the market value of the underlying shares,
- otherwise a discount for no liquidity should be taken into account.

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?

No, we do not agree. For consistency purposes, the reload option should be valued on the basis of conditions existing at grant date.

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?

No, no other feature seems to be taken into account, provided that proper attention is given to our answer to question 11 and that the option value obtained is adjusted to counter the effects of volatility.

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 followed by the Board.

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?

See our answer to question 18

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.

Our answers to questions 17 and 18 are joined since they follow the same rationale. They are consistent with our answer to question 9.

In our opinion, in most cases, an entity reprices options or cancels a share or option grant when it acknowledges that the share or option grant is not efficient any longer (the exercise price is well above market value) and that it cannot expect any service to go on being rendered. Therefore we strongly disagree with the draft IFRS that requires an expense to be accounted for until the end of the originally planned vesting period. In our view, this requirement is contrary to the draft standard internal logic, which is that an expense is recognised because a service is received.

Moreover, there may be situations (although probably rare) in which an entity cancels a plan, not because it has proved to be inefficient but because the entity has come with its employees to an agreement where the plan is cancelled but another form of consideration, in cash for example, is granted. This happens in case of mergers, for example. In our view, in that case, the only expense recognised in the period should be the cash consideration.

Accounting is meant to reflect reality as closely as possible. No standard would drive to a high quality of financial information when recognition and measurement requirements are designed to ignore events or decisions made by management. Therefore, no expense should be recognised on the basis of the conditions prevailing at inception, when management decisions or events have changed the underlying reality and that former plans have been cancelled, repriced or replaced.

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.

Yes, we agree.

Question 20

For share-based payment transactions in which either the entity or the supplier of goods or services may choose whether the entity settles the transaction in cash or by issuing equity instruments, the draft IFRS proposes that the entity should account for the transaction, or the components of that transaction, as a cash-settled share-based payment transaction if the entity has incurred a liability to settle in cash, or as an equity-settled share-based payment transaction if no such liability has been incurred. The draft IFRS proposes various requirements to apply this principle.
Are the proposed requirements appropriate? If not, please provide details of your suggested alternative approach.

Yes, we agree.

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)?

No, we do not agree, because the disclosures required would be both too burdensome for the preparers and far too detailed for the users. We recommend that disclosures concentrate on the information truly useful to users that are:

- the characteristics of all open share-payment arrangements, and for each of them:
- the option pricing models used,
- the assumptions retained as inputs into the models,
- the average exercise prices.

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.

In our opinion, no official requirement should be based on the publication date of an exposure-draft. The publication date of an exposure draft is no more than an invitation to comment. In retaining such a starting point, the Board seems to take the view that the draft will turn into a final standard, whatever the comments obtained might be. We wish that invitation to comment do not turn out to be invitations to have no comments.

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?

Yes, we agree.

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.

(Respondents may wish to note that further details of the differences between the draft IFRS and SFAS 123 are given in the FASB's Invitation to Comment.)

Answers to a)

- We do not agree with either position regarding employee share purchase plans. There should not be any exception based on the amount of discount granted. However we think that criteria should be set up in order to assess whether an employee share purchase plan compensates services (please refer to our answer to question 1).
- We are not in favour of such an option. However we believe that the option should be open as long as accounting principles have not been amended in the US in order to adopt a mandatory requirement (please refer to the last paragraph in Acteo's position general overview).
- We agree that unlisted entities should be permitted to apply the minimum value method, since determining the fair value of options cannot be achieved reliably. We would extend this possibility to recently listed entities (please refer to our answer to question 3).

Answers to b)

- We agree with the IASB draft that the fair value of an equity instrument should be reduced to reflect the possibility of forfeiture due to failure to satisfy vesting conditions.
- We agree with the IASB draft that the adequate measure should be based on the number of options not yet forfeited.

Answer to c)

- We agree with the IASB draft.

Answer to d)

- We agree with the IASB draft.

Answer to e)

- We agree with the IASB draft.

Answer to f)

- We agree with the IASB draft.

Question 25

Do you have any other comments on the Exposure Draft?

Convergence

Ever since the debate over share-based payments started, all commentators stressed the necessity of convergence with the US Gaaps, in order to ensure a level playing field to all IAS compliant entities.

The need for convergence is all the more critical that the requirements included in the IFRS draft standard are purely conventional. Therefore it is essential that convergence be fully achieved, on every single issue, between US Gaaps and IFRS. Following the issuance in the US of an exposure draft based on IASB's proposals, we believe that both the FASB should reconsider FAS 123 and APB 25 in the light of IASB's most recent work. Action has to be taken rapidly since the Board intends that the new standard be applied in 2005.

Complex option plans.

In case no reliable valuation can be achieved at grant date, the IASB draft concludes that an entity that has entered a scheme for which no valuation is available will not be compliant with IFRS. We strongly disagree with the Board on this issue. Accounting standards are not intended to restrict entities from accessing to arrangements for which no valuation is available. Decisions made by management are in the best interests of the company and should never be influenced by accounting regulations. Whenever the substance of the transaction is such that no fair value can be determined, requirements similar to IAS 39 paragraphs 95 and following should apply, namely disclosures should be deemed preferable to recognition.

Formal assessment obtained from the panel of experts.

An advisory council and a panel of experts have helped the Board be confident in the measurement requirements included in the draft standard. In our opinion, the experts involved should be listed nominatively and a formal assessment should be obtained from every option pricing specialist.