Institute of Certified Public Accountants in Israel
לשכת רואי חשבון בישראל

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Ms. Kimberley Crook
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E-mail: CommentLetters @ IASB.org.uk

Dear Ms. Crook,

Re: Comments on Exposure Draft ED 2 "Share-based Payment"

We respond to your invitation to comment on the Exposure Draft of the proposed IFRS "Share-based Payment" on behalf of the Institute of Certified Public Accountants in Israel.

We believe that the general principle underlying this standard, recognizing the fair value of an expense associated with the goods or services received by an entity when the consideration is related to the entity's shares, is appropriate and important.

In connection with the questions (1 - 25) that are attached to the draft IFRS, we would like to comment on the following questions (we concur with the proposed IFRS with regard to the other questions):

Question 1

The essence of our response is yes. In our opinion, the proposed scope of the draft IFRS should apply to all share-based payment transactions, apart from cash-settled based transactions. Practically, cash-settled based transactions constitute a type of a derivative which does not affect directly the entity's equity (equity instruments serve only as underlying assets and any other underlying assets could have been used). Accordingly, it seems that their treatment should be included under the scope of the IFRS which deals with derivative financial instruments, i.e. IAS 39.

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Question 3

The essence of our response is yes. In our opinion, explanations (in the IFRS or in the appendix) which relate to the measurement of the fair value of the following should be added:

1. Equity instruments of unlisted entities or when there is no “active” market for such instruments; and

2. Different types of equity instruments of entities (both listed and unlisted) which may be granted in return for services, for example: grant of Preferred shares that have other rights than Ordinary shares.

Questions 4 and 5

In our opinion the measurement date should be consistent - either the grant date or the date at which goods or services are obtained - regardless whether the fair value is measured directly or indirectly.

Also, in our opinion, in the case of continuous services (which may be provided over a long period of time), the measurement date should be not later than the date at which the service provider starts to render the services (and not for each part of the services in a separate point in time).

Question 8

Our response is positive as it relates to options granted to employees which have a vesting period. We think that with reference to paragraph 14 of the draft IFRS, in cases of suppliers and service providers other than employees the related expense should be accounted for during the performance period and not necessarily during the vesting period. On the other hand, when dealing with instruments that are granted to employees and that are conditioned upon their future service at the entity, it is difficult to refute the assumption that the performance period is different than the vesting period and therefore, the expense in respect thereof should be accounted for over the vesting period.

Question 12

Our response is positive. However, in our opinion, the measurement of the fair value as a basis for the measurement of the value of equity instruments requires also reference to other conditions relating to the grant of options, as follows:

a. When the options are non-transferable, non-marketable or non-exercisable upon the occurrence of certain events, we suggest that an example for the decrease in value as a result of the aforementioned should be included among the examples.

b. In reference to paragraph 22(b) of the draft IFRS, the underlying presumption in the estimate of the fair value in accordance with Black & Scholes model is that the options will be exercised at the end of the vesting period. However, the fair value of options that are subject to vesting period is lower compared to the fair value of options that are not subject to vesting period even under the presumption that the options will be exercised at the end of their vesting period. Therefore, in our opinion, the need to adjust the fair value of the options in case that an entity chooses to apply this model should be examined.

Question 13

Our response is positive, however we think that the acceptable method of computation should be clarified by additional examples and explanations while giving a greater emphasis on the binomial model which, in our opinion, under certain conditions is as appropriate for the computation of the value of options to employees as the Black & Scholes model. We think that giving additional provisions may improve the accuracy of the computed fair value and prevent distortions, mistakes and lack of comparability.

Question 14

We think that this is a very specific situation which should not be discussed together with the general principle and which should rather be referred to in the appendix (for example in the implementation guidance). In any case, it seems that the current models for the estimate of options fair value find it difficult to take into account such feature and, therefore, we think that this component should not be taken into account in measuring the fair value of an option. When new options are granted by virtue of same plan, they should be accounted for as new options, i.e. to measure their fair value at grant date.

Question 17

Our response is positive. In our opinion the second method illustrated in Example 3 of Appendix B whereby the total expense in respect of both grants is spread equally over the period is more appropriate, since this method makes a proper correlation between the total cost of service granted to the entity in the remaining periods and the overall remaining service period and it does not create a distortion in the recognition of the expense between the two periods. This approach is in line with the general approach to changes in estimates.

Question 18

In our opinion, the wording of paragraph 29 is unclear and, in any case, we do not agree to the accounting treatment proposed in paragraph 29(c).

We think that the treatment proposed in section (a) is appropriate if and only if it is applied to a situation where new options replace those cancelled or in an unreasonable situation where the service provider continues to render services without consideration. Consequently, this section should be clearly related to the relevant scenario and not remain as a separate subparagraph.

Second, as for paragraph 29(c), the section does not indicate the way according to which the entity decides whether it is a replacement plan (in our opinion, the entity should not be permitted to decide in this issue but should be obligated to refer to the replacement plan as a repricing) and it is unclear why at the grant date of new options which do not constitute a substitution to the cancelled options the entity should continue to recognize the expenses of the cancelled options in addition to the full expenses of the new options granted (It seems to cause an unjustified double expense).

In our opinion, the grant of new option, after cancelling the old options , constitutes a substitution to repricing. Accordingly, it is appropriate to determine that the expense to be recognized on the date when the new options are granted should be in the amount of the increment to the fair value of the cancelled options and not in the full amount of the fair value of the new options (in some cases), as proposed by the IFRS.

Question 19

We agree to the treatment. However, similar to our answer to Question 1, we think that these instruments should be accounted for according to IAS 39, which, as aforementioned, will not change the essence of the treatment.

Question 20

We agree to the general principle described in the draft IFRS. Notwithstanding the above, in connection with paragraph 42, we think that, in certain cases, the determination of an entity's present obligation should be reexamined. First, we do not think that heavy consideration should be given to a past practice of cash settlement of an entity since any entity makes the optimal financial decisions for it in each period and it is not practical to deduce from past considerations of an entity to its considerations in another period and under other circumstances. Second, we think that a more specified approach to the issue of the entity's choice is required and this despite the intention to focus on principles (for example, a requirement that an entity will have the ability to provide the equity instruments needed in order to settle in equity). This specific reference, including examples, may appear also in the context of general guidelines in one of the appendices to the IFRS (i.e. implementation guidance).

Question 22

Our response to this question is negative. According to paragraph 54, the draft IFRS is applicable to grants of equity instruments whose vesting period has not ended as of the date of publication of the draft IFRS. In our opinion, the IFRS should not be adopted retroactively and the approach contained in U.S. SFAS 148 which allows choosing one of three methods in order to present the transition from the application of APB 25 to the application of SFAS 123 regarding the accounting treatment of stock-options granted to employees should be applied:

a. The method determined in SFAS 123 - the prospective method which can be applied until the fiscal year ending December 15, 2003; or
b. The modified prospective method; or
c. The retroactive restatement method.

Question 23

Our response to this question is negative. We agree to the general principle that the related tax should be recognized in the statement of income, however, we wish to draw attention to cases where entities are entitled to reimbursement for expenses or to tax deductions on tax paid by the employee which is other than the amount according to which the benefit was created (for example, according to the tax laws in Israel). It these cases, a situation may occur in which the entity receives a reduction which is different from the tax expenses which it recognized in the statement of income for the options granted. It seems that the difference created should better be recognized in the statement of shareholders' equity and not in the statement of income, since at this stage (after the measurement date) it relates to an item related to shareholders' equity.

Question 25

We would like to make the following general comments:

a. In the summary table of Appendix E section E5 it seems that the amount for deferred tax assets in Year 2 should be revised from $ 33,333 to $ 62,667.

b. In order to avoid unclarity, in our opinion the term "market" should refer in the IFRS to "active market".

c. In Appendix B Example 3, it seems that the number of employees in the computation of the increment to the fair value should be corrected to 390 instead of 410 since on the date of the repricing the entity expects that 10 employees will leave in each of the remainder two years. We would like to point out that the existing employees number (410) stands in contradiction to the computation principles in previous examples.

d. In our opinion, an example should be added to Appendix B which deals with a scenario where an entity grants to its employees options to purchase shares at 85% of the market price at the date of exercise (a very common case).

e. In paragraph B 3 of Appendix B It is noted that in case of options granted to employees, which may be exercised by the employees over the vesting period in equal shares (for instance, a quarter of total options granted in each of four years), each share should be treated as separate vesting period, for the calculation of the amounts that should be charged to income in each year, resulting in an accelerated expense model, while the services by the employees are spread equally over the vesting period. In our opinion, the overall benefit should also be reflected in the income statements in equally (straight line) over the vesting period.

We would be pleased to give you any further clarifications, if needed.

Sincerely yours,

Adir Inbar, CPA (Isr.)
Chair, Professional Council

Aronon Ratzkovsky, CPA (Isr.)
Chair, Accounting Principles &
Financial reporting Committee