Lancaster University
MANAGEMENT SCHOOL

Department of Accounting and Finance

Comments on the IASB's ED2 made at the Business Performance Symposium on "The Future of Executive Incentive Plans", held in London, 16-17 January 2003

This brief note highlights specific comments that were made, during the above symposium, in relation to ED2. A fuller coverage of the symposium's proceedings, in the form of a Briefing Paper, may be downloaded from
http://www.icaew.co.uk/viewer/index.cfm?AUB=TB2I_48858

1. ED2 was supported by a majority of the audience but there were some notable exceptions, as can be seen from the Briefing Paper.
2. While most commentators accepted the IASB's decision to work through the issues within the constraints of the present conceptual framework, a key issue for future attention is the classification of stock options as equity (rather than as a liability). The issue is fundamental, because ED2's recommended accounting treatment of stock options follows two guiding principles – (1) options are equity and (2) once equity is recognised (it is accrued over the vesting period), it is not re-measured. In contrast, the accounting treatment of options relative to share appreciation rights is not easy to justify on substantive grounds.
3. Share prices behave in a manner that is inconsistent with the proposed accounting treatment. Typically, shares are priced as if there the reporting entity has an unrecognised asset on the grant date. Amortising the asset – or in ED2's terms, accruing the options as an equity account and simultaneously taking a charge against income – over the vesting period is on average too conservative.
4. Valuation methods are evolving. Consequently doubts were expressed about whether ED2's valuation guidance (eg, the most appropriate treatment of early exercise of stock options) will stand the test of time.
5. In places, ED 2 is fuzzy on the distinction between principle- and rule-based standards. If the IASB intends to issue principle-based standards, then it would be better to omit rule-like statements from the standard itself. Paragraphs 20-25 are a case in point. An alternative wording within the standard would be something like 'The valuation should take into account any provision in the option agreement that would have a material effect on the option's fair value.' Specific matters such as those canvassed in Paragraphs 20-25 could be mentioned in the supporting documents.
6. Participants welcomed the IASB's project on the statement of operating performance. Financial analysts and other users of financial statements said they will look forward to performance reports that separate the results of core operations from other items, eg, accounting numbers relating to employee and executive share options.
7. The implications of ED 2 for EPS calculations need attention – eg, FASB's "treasury stock" method appears to get it wrong, because it is based on the intrinsic value of options, not their fair value.

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