Foreningen af Statsautoriserede Revisorer
Kronprinsessegade 8, 1306 København K. Telefon 33 93 91 91
Telefax nr. 33 11 09 13 e-mail: fsr@fsr.dk Internet: www.fsr.dk

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Kimberley Crook, Project Manager
International Accounting Standards Board
30 Cannon Street, London EC4M 6XH
England

10 March 2003
enj/osj/dor (regu\kor\2003\IASB ED2)

Dear Madam

ED 2, Sharebased payment

We welcome the opportunity to provide comments on the Exposure Draft on behalf of the Danish Institute of State Authorised Public Accountants (FSR).

FSR's Accounting Standards Committee has reviewed the ED and we summarize our comments below. Our comments have been presented for the Danish Accounting Advisory Panel which represents users and preparers of financial statements.

Basically, we agree with the principles set up in the exposure draft. However, we have concern with respect of the complexity of the standard. Even though the principles set up might have theoretical merit, we see a risk that misunderstanding of the rules may lead to incorrect treatment of share-based payment.

We have the following comments to the questions raised in the exposure draft:

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?

Yes, we agree

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?

Yes, we agree

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?

Yes, we agree that this should be the basic principle. We are aware that normally such equity-instruments would be based on listed shares, however, we would find it useful if further guidance could be given on the area, for example in situations where there is not even an internal market established by the enterprise itself for the underlying shares.

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?

We see no advantage of having two different measurement dates depending on whether the fair value is measured with reference to the goods and services delivered or the consideration received. Further, requiring measurement date to be the date on which the goods or services are received would cause practical problems if the instruments were issued some time before the goods or services are delivered. In our view, such transactions are similar to prepayments and therefore, they should be recognised at inception. If the basis for measuring the transaction is not established before the date of delivery the transaction should either be measured on a provisional basis or not be recognised.

We therefore suggest that grant date is the measurement date.

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 the measurement date should always be grant date, cf. question 4.

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.

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?

Yes we agree. If measurement with reference to services delivered was allowed, we see a risk that certain transactions would be considered as having a 0 fair value, as share based payments are often seen as add-ons to the existing remuneration and not as an alternative.

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. However, there will probably be programmes where the major part of the vesting conditions *in substance* has been fulfilled at the date where the instruments are formally granted, namely where granting is conditional upon meeting certain performance measures. The earlier date at which the parties agree on these performance measures should probably be considered as grant date as defined in the exposure draft. However, it may be necessary to address directly in the standard how such programmes should be accounted for.

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?

We have some concern with the proposed model, since the up-front assessment of the number of employees expecting to fulfil the vesting conditions could have a direct impact on the total amount expensed, regardless of the actual number of employees fulfilling them.

This would be the case with two different expectations with respect of the number of employees fulfilling the vesting conditions but with *identical expected units of service*. If for example the percentage of employees in example 1, appendix B, expecting to vest was set to 70 instead of 80 and the units of service delivered was unchanged set to 1,350, the total cost would be 525,000 instead of 600,000, if the actual units of service delivered were as expected.

Further, if for example 50 employees were expected to leave every year instead of 33, the fair value of each unit of service would be 411.76 (750,000 * 350/500 = 525,000: (475+425+375)). The maximum expense would consequently be reduced to 617,640 (1,500 * 411.76) instead of 666,667 (444.44 *1,500).

We are aware that normally the number of units of service should be lower if the number of employees expecting to vest is lower.

An alternative, simpler, model would be to fix the total amount, regardless of the number of employees actually leaving. This may be justified, since the total expense is also dependent on the up-front assessment of the number of employees fulfilling the vesting conditions in the model proposed in ED 2, cf. above. Fixing the total expense could be achieved through an ongoing assessment of the number of employees expecting to leave. The following example illustrates this:

The fair value and the original expectation is the same as in appendix B, i.e. the basis is 600,000. After 1 year, the actual number of employees having left is 50. The expectation for the following two years is 33. Hereafter, the total units of service will be 450 + (0.5 * 50) + 417 + (0.5 * 33) + 384 + (0.5 * 33) = 1,309 or 458.36 per service unit. The expense for year 1 is thereafter 217,723. If employees leave as expected in year 2 and 3, the expense will be 198,931 and 183,346 respectively. The total expense would amount to 600,000. Depending on the level of employee turnover, an approximate value could often be achieved by recognizing the expense on a linear basis over the vesting period.

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?

Yes, we agree with the proposed requirement, because the expense recognised should reflect the value of services actually delivered and not a theoretical value calculated subsequently.

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?

Yes, we agree

Question 12
If an option is non-transferable, the draft IFRS proposes that the expected life of an option rather than its contracted life should be used in applying an option pricing model

(paragraph 21). The draft IFRS also proposes requirements for options that are subject to vesting conditions and therefore cannot be exercised during the vesting period (paragraph 22). Do you agree that replacing an option's contracted life with its expected life when applying an option pricing model is an appropriate means of adjusting the option's fair value for the effects of non-transferability? If not, do you have an alternative suggestion? Is the proposed requirement for taking into account the inability to exercise an option during the vesting period appropriate?

We agree that replacing contracted life of the option with expected life is an appropriate adjustment for *non-transferability.*

We suggest that in such situations, a model, which takes the *non-exercisability* feature into effect, should be required. This would for example imply that a binomial model, which is based on exercisability at any time of the contracted life, could not be used. However, we agree with the Board that no specific model should be required. See also question 16

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?

Yes we agree that such vesting conditions should be taken into effect when estimating the fair value. However, we see a risk that the adjustment will be very subjective in practice. For vesting conditions, which are either-or, i.e. the options are vested in full if the conditions are met, and forfeited completely, if the conditions are not met, we therefore suggest that there should be a rebuttable presumption that the vesting conditions are met.

Question 14
For options with a reload feature, the draft IFRS proposes that the reload feature should be taken into account, where practicable, when an entity measures the fair value of the options granted. However, if the reload feature is not taken into account in the measurement of the fair value of the options granted, then the reload option granted should be accounted for as a new option grant (paragraph 25). Is this proposed requirement appropriate? If not, why not? Do you have an alternative proposal for dealing with options with reload features?

We believe that in most cases it will not be practicable to include the reload feature in the fair value measurement of the options granted. Unless IASB can give more guidance as to how to calculate the value of the reload feature, we recommend that the reload feature is not taken into account in the measurement of the fair value of the options granted, but rather that the reload option is accounted for as a new option grant. In practice there will not necessary be material differences between the expense recognised under the two methods since inclusion of the reload-feature would imply recognition over a longer period.

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

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?

Basically, we agree that no specific model should be required. However, we find that some guidance should be given on areas where use of one model could clearly conflict with the objective, for example use of models which do not take non-exercisability into effect, if the options are actually non-exercisable during a period. See the answer to question 12.

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?

We agree with the approach, if the re-pricing is not combined with an extension of the vesting period. However, if the re-pricing is combined with extension of the vesting period, we find that the transaction should be seen as one, i.e. the incremental amount should be recognised over a period until the new vesting date in accordance with the general rules of the draft standard. We find that splitting the two elements the way it is done in the example does not reflect the economic substance of the transaction.

We suggest, that examples on how to account for the effect of changes in terms are given on other areas, for example extension of the vesting period or extension of the life of the option.

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.

Yes, we agree with the principles.

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 with the approach. However, we find that guidance on income statement classification of the change in fair value should be given. If such guidance were not given, practice would probably be diversified. In our view, the part classified as operating costs should be based on the fair value per SAR at grant date and all other changes in fair value should be classified as financial items.

The following example illustrates the approach. The SAR-programme is granted in year 1 and vests at the end of year 3.

	Year	**1**	**2**	**3**
1	Fair value per SAR	20	30	25
2	Number of employees	500	475	450
3	Liability	20*500/3 = 3,333	=30*475*2/3= 9,500	=25*450 = 11,250
4	Change if fair value	-	6,167	1,750
5	Operating expenses	=20*500/3=3,333	=20*475/3=3,167	=20*450/3=3,000
6	Financial items (4-5) (= income)	-	3,000	(1,250)

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 with the approach.

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)?

Yes, we basically find the disclosure requirements appropriate.

We have some concern about the extent of disclosures required. However, we agree that in a standard like ED 2, where measurement is based so extensively on assumptions made and choice of model(s), extensive disclosure requirements regarding these factors is necessary if the financial statement are to be understandable and comparable.

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 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.

We do not find it appropriate to require an entity to apply the requirements of the standard to equity instruments granted after the publication of the Exposure Draft but before publication of the final standard. This would imply unnecessary uncertainty because some entities could base issuance of option programmes on the expectation that the new rules would apply, while others would not. The approach would especially be questionable, if some of the principles in the exposure draft are changed.

We do not find full retrospective application appropriate, as assessment of the fair value and the P/L recognition of share option programmes to some extent could imply use of hindsight, for example the assessment of employee turnover. We therefore suggest application from the publication date of the final standard or from a fixed date after the publication.

We agree that the rules for liabilities existing at the effective date of the IFRS should be applied retrospectively.

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. 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.)

(a): Yes we agree that the standard should not include the exemptions contained in FAS 123.
(b): Yes, we agree with the draft IFRS. See question 13
(c) Yes, we agree with the draft IFRS. See question 18
(d) Yes, we agree that the measurement date should always be the grant date. See question 4 and 5
(e) Yes, we agree with the draft IFRS. See question 19
(f) Yes, we agree with the draft IFRS. See question 23

Question 25
Do you have any other comments on the Exposure Draft?

Disclosure of cash amount necessary on exercise of in-the-money share options
Exercise of in-the-money share-options requires a cash outflow from the entity, unless the entity owns treasury shares, because the entity is required to purchase treasury shares at market price and sell them at a lower price. However, because the instruments are classified as equity-instruments, no liability is recognised. For the purpose of underlining this fact, we find that IASB should consider whether there should be a requirement to disclose the amount of cash necessary to settle such obligations, similar to the requirement to disclose dividends proposed for the financial year. The entities having sufficient treasury shares to settle the obligation would disclose the amount 0, which in our view is useful information.

Earnings per share
In our view, the calculation of earnings per share would to some extent be "disturbed" by share-option plans. The direct effect on the other shareholders is a dilution and therefore, the actual earnings per share seem to be underestimated, if earnings are not adjusted for the share-option expense. An enterprise with constant growth rates and with a constant P/E ratio could – depending on the underlying assumptions – for example report a rise in earnings per share beyond the real growths rate. On the other hand, if earnings were adjusted for the share-option expense, the rise in earnings per share would be lower than the real growths rate, which seems to be the correct answer from the view of the present shareholders.

Yours faithfully

Eskild Nørregaard Jakobsen
Chairman of FSR's Accounting
Standards Committee

Ole Steen Jørgensen
Head of Department