

International Accounting Standards Board
30 Cannon Street
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Cc Paul Ebling, Accounting Standards Board

Dear Ms Crook

ED2 SHARE-BASED PAYMENT

Thank you for the opportunity for the Chartered Institute of Management Accountants to comment on this new standard. A hard copy has also been posted today, as requested. The Chartered Institute of Management Accountants (CIMA) is a global professional body specialising in management accounting. CIMA represents over 74,000 students and 57,000 members in 156 countries.

The responses to your specific questions are attached below. There are also general points that we think it important to make.

CIMA can accept the view that the economic gain made by existing shareholders when options lapse unexercised has no place in the profit and loss account, even when considered on a comprehensive basis. Nevertheless there is no denying that such gains, when they occur, are real, and are of importance and interest to the shareholders. The value of unexercised options at the start and end of the year, and a reconciliation of movements, needs to be presented in the accounts clearly and logically, with comparatives, in a consistent position. This will help to mitigate some of the counter-intuitive effects of the proposed standard. For example, under some circumstances the early cancellation of options, which is clearly an economic gain to shareholders, can lead under the proposals to an increased charge to the profit & loss account, offset by a greater gain in reserves.

CIMA feel it would be helpful to have some guidance and discussion generally of the treatment of the balance sheet entry that matches the profit & loss account charge when a share-based payment transaction is recognised.



Finally, as we have said in response to previous exposure drafts, CIMA prefers that there should be as few changes as possible to financial reporting requirements, in the two years prior to 2005, as the business community should be allowed to concentrate on what it needs to do for the large-scale adoption of IAS in 2005. In the interests of comparability and a level playing field, CIMA would also like to see as much as possible of the business community adopting new reporting requirements simultaneously, rather than isolated early adoption.

Yours sincerely

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IASB 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, the proposed scope seems appropriate.

IASB 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, the proposed recognition requirements seem appropriate.

IASB Question 3

For an equity-settled share-based payment transaction, the draft IFRS proposes that, in principle, the entity should measure the goods or services received, and the corresponding increase in equity, either directly, at the fair value of the goods or services received, or indirectly, by reference to the fair value of the equity instruments granted, whichever fair value is more readily determinable (paragraph 7). There are no exemptions to the requirement to measure share-based payment transactions at fair value. For example, there are no exemptions for unlisted entities.

Is this measurement principle appropriate? If not, why not, or in which circumstances is it not appropriate?

CIMA agrees with the measurement principles.

IASB Question 4

If the fair value of the goods or services received in an equity-settled share-based payment transaction is measured directly, the draft IFRS proposes that fair value should be measured at the date when the entity obtains the goods or receives the services (paragraph 8).

Do you agree that this is the appropriate date at which to measure the fair value of the goods or services received? If not, at which date should the fair value of the goods or services received be measured? Why?

CIMA agree that the date that the service is rendered, or the goods received, should be the date at which the fair value should be measured. The choice between service date and grant date is an obscure one, but we think service date is theoretically correct.

IASB Question 5

If the fair value of the goods or services received in an equity-settled share-based payment transaction is measured by reference to the fair value of the equity instruments granted, the draft IFRS proposes that the fair value of the equity instruments granted should be measured at grant date (paragraph 8).

Do you agree that this is the appropriate date at which to measure the fair value of the equity instruments granted? If not, at which date should the fair value of the equity instruments granted be measured? Why?

CIMA believe this is the appropriate date at which to value the equity instruments granted. It is at this point that both parties to the agreement have crystallised their expectations of the trade, and found the exchange acceptable. The risks and rewards of subsequent changes in share value are borne by the recipient.

IASB 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?

CIMA agrees this is generally so for transactions other than employee services.

IASB Question 7

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

CIMA agrees that for employee services, it is generally easier to value equity instruments. However, it is possible that there may be circumstances, perhaps in other countries, where this is not so. Thus CIMA would prefer the IFRS to have a rebuttable presumption that the fair value of equity instruments is more easily determinable than the fair value of employee services, rather than the proposed definite assumption. There should be an accompanying requirement to disclose fully the circumstances when the presumption is rebutted to discourage abuse of this provision.

IASB 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?

Generally it is reasonable to assume this, but not in all circumstances. In some cases, the equity instruments would be not only consideration for services to be received, but also for services received in the past. We believe the standard should require that the services are assumed to be performed during the vesting period unless there is clear evidence to the contrary.

IASB Question 9

If the services received are measured by using the fair value of the equity instruments granted as a surrogate measure, the draft IFRS proposes that the entity should determine the amount to attribute to each unit of service received, by dividing the fair value of the equity instruments granted by the number of units of service expected to be received during the vesting period (paragraph 15).

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

CIMA agrees the unit of service approach is necessary.

IASB Question 10

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

The theoretical basis for the proposal not to allow 'truing up' is not clear, and we believe a good case can be made for allowing 'truing up' until vesting date for all or some movements. For example "truing up" could be permitted in cases where an employee leaves before the vesting date, forfeiting his option. Using grant date as the measurement point for the equity instruments also generates problems for entities when an economy experiences a significant realignment of share values, as has happened over the last three years. In such cases employees are unlikely to be motivated by valueless options, whether or not formally cancelled, whereas the proposed standard will cause them to be reported as a significant expense.

However, any change to the grant date approach would have repercussions throughout the standard, and there are equivalent problems with the vesting date model. We believe the way forward is to report clearly in the accounts the economic gain from lapsed options – prospectively and retrospectively – and to specify more clearly the related reserve accounting in the standard. Companies should be encouraged to comment on these movements, alongside the related profit & loss account movements.

IASB 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?

CIMA agrees that the option pricing model should be used.

IASB 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?

CIMA agrees that this methodology is appropriate, but questions whether an option can really be considered non-transferable, given that it is usually possible to draft a contract to transfer the benefits of an option, even if the option itself is not transferable?

IASB Question 13

If a grant of shares or options is conditional upon satisfying specified vesting conditions, the draft IFRS proposes that these conditions should be taken into account when an entity measures the fair value of the shares or options granted. In the case of options, vesting conditions should be taken into account either by incorporating them into the application of an option pricing model or by making an appropriate adjustment to the value produced by such a model (paragraph 24). Do you agree that vesting conditions should be taken into account when estimating the fair value of options or shares granted? If not, why not? Do you have any suggestions for how vesting conditions should be taken into account when estimating the fair value of shares or options granted?

CIMA agree the conditions should be taken into account, if truing up is not permitted.

IASB 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?

CIMA agree with this proposal.

IASB 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?

CIMA consider the proposals to be conceptually sound and cannot identify any other common features to include.

IASB 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?

CIMA do not consider that such guidance should be included in the IFRS, but left to specialists to develop and promulgate best practice.

IASB Question 17

If an entity reprices a share option, or otherwise modifies the terms or conditions on which equity instruments were granted, the draft IFRS proposes that the entity should measure the incremental value granted upon repricing, and include that incremental value when measuring the services received. This means that the entity is required to recognise additional amounts for services received during the remainder of the vesting period, 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?

CIMA cannot envisage many entities repricing when it is more convenient to cancel the option and start a new scheme. CIMA prefers the first of the two methods illustrated in Example 3.

IASB Question 18

If an entity cancels a share or option grant during the vesting period (other than a grant cancelled by forfeiture when the vesting conditions are not satisfied), the draft IFRS proposes that the entity should continue to recognise the services rendered by the 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.

CIMA consider that this proposal is logical but counter-intuitive. It has the merit of consistency and it is difficult to suggest an alternative approach.

IASB 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.

CIMA agrees with the proposed approach.

IASB 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 consider the proposals appropriate.

IASB Question 21

The draft IFRS proposes that an entity should disclose information to enable users of financial statements to understand:

- (a) the nature and extent of share-based payment arrangements that existed during the period,*
- (b) how the fair value of the goods or services received, or the fair value of the equity instruments granted, during the period was determined, and*
- (c) the effect of expenses arising from share-based payment transactions on the entity's profit or loss.*

Are these disclosure requirements appropriate? If not, which disclosure requirements do you suggest should be added, deleted or amended (and how)?

These disclosures are too extensive, and focus too much on the benefit to directors from options, and not at all on the economic impact of options on the company, which could be highly significant. Too voluminous disclosures do not benefit shareholders, and can obscure important information. CIMA consider that the value of unexercised options at the start and end of the year, and a reconciliation of movements, needs to be presented in the accounts clearly and logically, with comparatives, in a consistent position in the accounts.

IASB Question 22

The draft IFRS proposes that an entity should apply the requirements of the IFRS to grants of equity instruments that were granted after the publication date of this Exposure Draft and had not vested at the effective date of the IFRS. It also proposes that an entity should apply retrospectively the requirements of the IFRS to liabilities existing at the effective date of the IFRS, except that the entity is not required to measure vested share appreciation rights (and similar liabilities) at fair value, but instead should measure such liabilities at their settlement amount (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.

CIMA agrees with the proposed approach.

IASB 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?

CIMA considers these proposals seem sensible.

IASB Question 24

In developing the Exposure Draft, the Board considered how various issues are dealt with under the US standard SFAS 123 Accounting for Stock-Based Compensation, as explained further in the Basis for Conclusions. Although the draft IFRS is similar to SFAS 123 in many respects, there are some differences. The main differences include the following:

- (a) *Apart from transactions within the scope of another IFRS, the draft IFRS does not propose any exemptions, either from the requirement to apply the IFRS or from the requirement to measure share-based payment transactions at fair value. SFAS 123 contains the following exemptions, none of which are included in the draft IFRS:*

- *employee share purchase plans are excluded from SFAS 123, provided specified criteria are met, such as the discount given to employees is relatively small;*

CIMA believe that the proposed IAS approach, to include all share-based payment, is the correct one, though politically unpopular.

- *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*

CIMA prefer fair value to intrinsic value, for which there is no logical justification.

- *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).*

CIMA would accept this methodology.

- (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.*

This is an acceptable alternative methodology, which would imply other consequential changes to the proposed IFRS.

- *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.

This is an acceptable alternative methodology, which would imply other consequential changes to the proposed IFRS.

- (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.*

CIMA prefer the IFRS approach, subject to the comments in the response to Question 18.

- (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.*

CIMA would accept this methodology.

- (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).*

CIMA prefer the IFRS approach.

- (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.

CIMA prefer the IFRS approach as more logical.

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.

In general, where the IFRS has chosen not to follow SFAS 123, their decisions have been logical. Those entities which have to prepare accounts under both regimes will regret the differences between them, but it is preferable for IASB to construct a logical standard than to import requirements which are deficient. CIMA would urge FASB will take an early opportunity to amend SFAS 123.

IASB Question 25

Do you have any other comments on the Exposure Draft?

CIMA do not have any other comments.