Exposure Draft

Accounting Standard (AS) 102

Share-based Payments

Scope

Para: 2 - 7

Comments:

SIRC of ICAI agrees with Scope of ED and would like to add the following observations:

The scope excludes a transaction with an employee in his/her capacity as a holder of equity instruments of the entity is not a share-based payment transaction. Dividend yields have a negative relationship with fair value of stock option. It I also true, Stock options lose their attraction when they are recognized as expense in the P&L statement. The income statement reflects company revenues and expenses over a fiscal year including compensation expenses to calculate the net income or a net loss for the period. Compensation expenses are accruals for long-term cash payments that companies expect to pay in the future. At the end of the period of the income statement, the accrued compensation expenses are transferred to the balance sheet and this is known as a liability. The stock option transaction will affect shareholders directly and not the company itself. In particular, the transfer of wealth is from existing shareholders to holders of employee stock options. Stock options have values to employees and involve a cost to employers as operating expenses of doing business. The expenses of employee stock option are measured when the options are granted and recognized over time. Hence, when stock options are granted to an employee, an asset is created, and then stock options get depleted through employees providing service. Furthermore, expenses in the transaction represent the consumption of resources received in "using up" for the shares or share options. Eventually, the entire amount is recognized for the resources received when the shares issued would be recognized as an expense (including any residual value, which would form part of the measurement of the gain or loss on disposal of the asset. Hence, employee stock options are valuable financial instruments and valuable considerations for employee services. The fact is if companies do not recognize fair value of employee stock options as an expense at the granted date, they will overstate their net income thus misleading the user of financial statements.

Recognition

Para: 8 -10

SIRC of ICAI agrees with the proposals.

Equity-settled share-based payment transactions

Para:11 - 15

Overview

SIRC of ICAI notes that when the entity settles the withholding tax, the cash payment is likely to differ from the cost recognised during the vesting period for the number of equity instruments needed to equal the monetary value of the tax. The amendment does not address the treatment of any such difference. ED May add few more Examples and the outcome of the example should be consistent with the underlying analysis that the plan is an equity settled plan and the withholding tax an expense of the beneficiary, not of the entity.

The ED may examine in a more comprehensive way how a net settlement feature (be it due to tax regulations, contractual terms or other facts) affects the classification of a share-based plan.

Transactions in which services are received

Para 16 -17

Comments:

The ED prescribes that the measurement shall be done at grant date. SIRC of ICAI support this approach and believe that the fair value of the goods or services received should consistently be measured at grant (contract) date, which is the date when the two parties agree on the value of the goods or services to be provided. Such a true grant date model is consistent with the measurement basis of other executory contracts.

SIRC of ICAI agree with the treatment proposed in the ED which requires that the cost related to goods or services has to be recognized when they are received. In case of long term contract services in which the contract price is stated at the agreement date, the fair value will be determined at that date.

The requirement for transactions with employees "to measure the fair value of the employee services received by reference to the fair value of the equity instruments granted" may be restrictive. Indeed, it is true that in many cases it will not be possible to measure directly the services received. When allocating share-based payments, certain entities start from the total remuneration of an employee. After deduction of the remuneration in cash and benefits in kind, the remainder is granted via a share-based payment transaction. In such instances, the fair value of the employee services received is available and should therefore not be determined indirectly.

Vesting conditions should affect the expense recognised. However, we believe it would be more logical not to include these in the calculation of the fair value of the option but instead require an adjustment to the value produced by such a model. Such an "adjusted" fair value best reflects the fair value of the services expected to be received at grant date.

When vesting conditions comprise performance conditions that must be satisfied, determination of the "appropriate adjustment" can become very arbitrary. Determination of the weighted average probability that the performance target will be achieved, is very judgmental. To address this concern, it could be envisaged to have a rebuttable presumption that the target will be achieved. If, on the other hand, an adjustment is made to reflect the probability that the performance target will be achieved, we believe that the standard should include documentation requirements to support the estimate made.

Transactions measured by reference to the fair value of the equity instruments granted

Para: 18 – 28

Comments

Complexity may arise from measurement at grant date or reporting date fair value could be reduced if entities were required to measure all (ie both equity- and cash-settled) share-based payment arrangements at their intrinsic value.

ED allow entities to use intrinsic value for measurement, but only when the fair value of the equity instruments cannot be estimated reliably. In those circumstances, the intrinsic value is re-measured at each reporting date until the settlement date of the arrangement (ie the intrinsic value is measured at the reporting date not at the grant date)

The intrinsic value of an option, however, does not reflect its full value. For example, share options sometimes have zero intrinsic value at the grant date, because the exercise price might be set up at the level of the shares' market value at the grant date. Nevertheless, these share options have an economic value because of the right to participate in future gains.

Modifications to the terms and conditions on which equity instruments were granted, including cancellations and settlements

Para:29 - 33

The ED may add-

Where a cash-settled share-based payment changes to an equity-settled share-based payment because of modifications of the terms and conditions, the original liability recognised in respect of the cash-settled share-based payment is derecognised and a new equity-settled share-based payment is recognised at the modification date fair value, to the extent services have been rendered up to the modification date. Any difference between the carrying amount of the liability and the amount recognised in equity at the same date is recognised in the income statement immediately.

Cash-settled share-based payment transactions

Para:34 to 37

Comments:

SIRC of ICAI agrees with the proposals in ED, but adds-

For cash-settled share-based payment transactions, the goods or services acquired and the liability incurred are measured at the fair value of the liability. Until the liability is settled, the fair value of the liability is re-measured at each reporting date and at the date of settlement, with any changes in fair value recognised in profit or loss for the period.

Example of cash-settled share-based payments include share appreciation rights, where employees are entitled to a future cash payment, the amount of which is based on the increase in the entity's share price over a specified period of time. An arrangement where employees are entitled to shares which must immediately be redeemed on vesting is also, in substance, a cash-settled share-based payment.

The entity transfers cash to the tax authorities rather than the counterparty, but this does not mean that the entity 'has no obligation to settle the transaction with the supplier'. The requirement to pay cash to the tax authorities arises from the interaction of the share-based payment transaction and the tax law. Thus in return for receiving/acquiring services from the counterparty, the entity has 'incurred a liability to transfer cash'. Although the obligation on the entity is to pay cash to the tax authority rather than to the counterparty, the staff understands that the tax obligation remains that of the counterparty and that the entity is acting as agent and is settling the tax obligation on behalf of the counterparty. Thus, in making the cash payment to the tax authorities, two obligations are being fulfilled:

(a) The entity is fulfilling its obligation to pay for the services received from the counterparty. It is acting as a principal in this respect; and

(b) It is acting as agent on behalf of the counterparty in transferring cash to the tax authority.

The reporting date fair value measurement model for cash-settled share-based payment arrangements does not require such a classification of vesting and non-vesting conditions, because this model accounts for all conditions (both vesting and non-vesting) in a way that reflects circumstances at the reporting date.

Treatment of vesting and non-vesting conditions

Para:38 - 41

Comments:

The SIRC of ICAI makes the following views:

While there might appear to be a vesting period over which the grant accrues, the lack of any service condition means that this period cannot be treated as a vesting period. Instead, the performance rights would be fair valued at the grant date, with the fair value determination taking into account the probability of the hurdles being met. This amount would be recognised as an expense immediately, and would not be subject to any further adjustment, regardless of whether the performance hurdles are met.

If there is no service condition within the terms of the grant, then there is no vesting condition and therefore and no vesting period. This means that the expense must be recognised immediately. This can lead to unexpected or unwelcome results where service conditions are not explicitly included in grant agreements.

A grant of equity instruments might be conditional upon satisfying specified vesting conditions. For example, a grant of shares or share options to an employee is typically conditional on the employee remaining in the entity's employ for a specified period of time. There might be performance conditions that must be satisfied, such as the entity achieving a specified growth in profit or a specified increase in the entity's share price. Vesting conditions, other than market conditions, shall not be taken into account when estimating the fair value of the shares or share options at the measurement date. Instead, vesting conditions shall be taken into account by adjusting the number of equity instruments included in the measurement of the transaction amount so that, ultimately, the amount recognised for goods or services received as consideration for the equity instruments granted shall be based on the number of equity instruments that eventually vest. Hence, on a cumulative basis, no amount is recognised for goods or services received if the equity instruments granted do not vest because of failure to satisfy a vesting condition, e.g. the counterparty fails to complete a specified service period, or a performance condition is not satisfied.

To apply the requirements of the above paragraph, the entity shall recognise an amount for the goods or services received during the vesting period based on the best available estimate of the number of equity instruments expected to vest and revise that estimate, if necessary, if subsequent information indicates that the number of equity instruments expected to vest differs from previous estimates. On the vesting date, the entity shall revise the estimate to equal the number of equity instruments that ultimately vested.

Market conditions, such as a target share price upon which vesting is dependent, shall be taken into account when estimating the fair value of the equity instruments granted. Therefore, for grants of equity instruments with market conditions, the entity shall recognise the goods or services received from a counterparty who satisfies all other vesting conditions, (e.g. services received from an employee who remains in service for the specified period of service) irrespective of whether that market condition is satisfied.

Share-based payment transactions with a net settlement feature for withholding tax obligations

Para:42-45

Comments:

Tax laws or regulations may oblige an entity to withhold an amount for an employee's tax obligation associated with a share-based payment and transfer that amount, normally in cash, to the tax authority on the employee's behalf. To fulfil this obligation, the terms of the share-based payment arrangement may permit or require the entity to withhold the number of equity instruments equal to the monetary value of the employee's tax obligation from the total number of equity instruments that otherwise would have been issued to the employee upon exercise (or vesting) of the share-based payment (i.e. the share-based payment arrangement has a 'net settlement feature'). Where the entity settles the share-based payment arrangement net, a share-based payment is classified as equity-settled in its entirety if the share-based payment would have been classified as equity-settled without the net settlement feature.

This only applies to a net settlement feature where there is an obligation on the entity under tax laws or regulations to withhold an amount for the employee's tax obligation associated with the share-based payment.

Any shares held in excess of the tax obligation will be accounted for as a cash-settled share-based payment where this amount is paid to the employee in cash or other assets.

Share-based payment transactions with cash alternatives

Para:46 - 52

SIRC of ICAI agrees with the proposal.

SIRC of ICAI would like to make the following observation:

Transactions measured by reference to the fair value of the equity instruments granted there is a possibility of just one award of instruments during the reporting period. In such cases, issuers may disclose the actual fair value of the awards granted. Some issuers may grant a number of awards during the reporting period and disclose the fair value of each grant of instruments rather than the weighted average fair value. Also issuers may not disclose how expected volatility was determined.

Disclosures

Para 62-70

SIRC of ICAI support the disclosure principles but believe in minimum disclosure requirements set out in detail.

The disclosures should support the understanding and interpretation of the amounts recognized and are not to be considered as stand-alone information. Disclosure should concentrate on the factors to which the estimated amounts are the most sensitive, particularly if they relate to an assumption that is essentially subjective. The proposed level of disclosure may be burdensome for the preparers and it may also obscure the key messages to the users of financial statements. The object of disclosure should not be to enable users to check the calculation made by the entity. Therefore, some of the 'Disclosures' may be illustrative rather than minimum disclosure rules.