

IAS Briefing

I s s u e 8

D e c e m b e r 2002

This issue of IAS Briefing covers the IASB's October and November meetings. It also reports on the new Exposure Draft ED 2 Share-based payment which was issued for public comment on 7 November and has a potentially immediate impact.

ED 2 Share-based payment

ED 2 Share-based payment proposes to require entities to recognise all share-based payment transactions in their financial statements. The proposed standard excludes only business combinations and contracts that fall under the scope of IAS 32 and IAS 39 (financial instruments).

In a share-based payment transaction the ED proposes that goods be recognised when they are obtained and services be recognised as they are received. If goods and services do not qualify for recognition as an asset, they are expensed. If the transaction is to be settled in equity, equity is increased. If it is to be settled in cash, a liability is recorded. Goods include a wide range of items from inventories to intangibles.

The proposals cover three different types of transaction:

(a) Equity-settled share-based payment transactions

ED 2 proposes that an entity measure the goods or services received and the corresponding increase in equity either at the fair value of the goods or services received, or by reference to the fair value of the equity instruments granted, whichever fair value is more readily determinable.

For transactions with parties other than employees, there is a rebuttable

presumption that the fair value of the goods or services received is more readily determinable. For transactions with employees, the entity is required to measure the fair value of the equity instruments granted.

The draft IFRS does not require a specific valuation method, but mentions the binomial and Black-Scholes models as option-pricing models which may be used (with suitable adjustments) if there is no readily determinable fair value.

The IASB proposes that share-based payments that are based on the fair value of equity instruments will be measured at their grant date. Once measured, the option value would not be revised in subsequent periods if the shares or options lapse or are forfeited, for example because of a failure to meet the vesting conditions.

Transactions measured at the fair value of goods and services received are measured at the date of receipt of those goods or services.

The IASB has developed a units of service method to measure and allocate the value of share-based payments when services are measured by reference to the fair value of the equity instruments granted. A portion of the determined fair value is allocated to each period and recognised as an expense and as an increase in equity as the units of service are received.

Effectively this spreads the expected cost and builds up equity incrementally over the vesting period.

(b) Cash-settled share-based payment transactions

For cash-settled share-based payment transactions the ED proposes that entities measure the goods and services acquired and the liability incurred at the fair value of the liability. The liability has to be remeasured to fair value at each reporting date, with any changes in value recognised in the income statement, until the liability is settled.

(c) Transactions where there is a choice of cash or other share-based settlement

Complex requirements cover share-based payment transactions where either the entity or the supplier may choose whether the transaction is settled in cash or by issuing equity instruments. The entity has to identify and account separately for the liability and equity components of such transactions.

The standard applies prospectively to all equity-settled transactions granted after 7 November 2002, unless they have vested before 1 January 2004 (the expected effective date).

Business Combinations (Phase II)

Both the IASB and the FASB have active projects on the application of the purchase method of accounting. The IASB reconsidered the scope of its project in order to expand it to consider jointly with the FASB all issues associated with minority interests. As a result, the Board added the following topics to its agenda:

- decreases in the parent's ownership interest after a business combination; and
- display of minority interests in the consolidated income statement or statement of changes in equity.

The Board tentatively agreed that the "full goodwill method" should be used in an acquisition of less than a 100 percent interest. Under this method, all of the goodwill of the acquired entity (the acquirer's and the minority interest's share) is recognised.

Convergence

The Board agreed that the following projects should be finalised and applicable for periods beginning on or after 1 January 2005:

- first-time application of IFRSs;
- improvements - general;
- improvements - financial instruments;
- business combinations (phases I & II);
- share-based payment;
- convergence (short-term strategy); and
- insurance (phase I).

In addition to dealing with longer-term convergence topics, the Board expects to issue the following (amendments to) standards during 2004 and 2005.

The mandatory application dates will be after 2005, with early adoption encouraged:

- post-employment benefits;
- performance reporting;
- revenue and liabilities;
- consolidations (including SPEs);
- segment reporting; and
- deposit taking, lending and securities activities.

Improvements projects

The Board considered a preliminary analysis on the comments received and mainly approved the proposed amendments. For details please see the May 2002 IAS Briefing, issue 5.

Insurance contracts (Phase I)

The Board tentatively agreed that an insurance contract should be "*a contract under which one party (the insurer) accepts significant insurance risk by agreeing with another party (the policyholder) to compensate the policyholder or other beneficiary if a specified uncertain future event (the insured event) adversely affects the policyholder or other beneficiary.*"

Additionally, the Board agreed:

- to use this definition of insurance contracts throughout IFRSs;
- to change all scope exclusions in IFRSs that refer to "insurance entities" to "insurance contracts";

- to define a reinsurance contract as an insurance contract issued by one insurer (the reinsurer) to indemnify another insurer (the cedant) against losses on an insurance contract issued by the cedant;

- to remove from IAS 32 and IAS 39 the scope exclusion for derivatives based on climatic, geological, or other physical variables.

- that to the extent that investment or deposit cash flows are independent from the cash flows of the insurance component in a contract, the investment components should be unbundled and accounted for separately in accordance with IAS 39.

While the Board concluded that in general IAS 39 would be applicable for investment contracts (contracts that do not contain enough insurance risk to qualify as insurance contracts), it also confirmed that no general further guidance was needed. However the Board decided to give detailed implementation guidance on specific issues as part of the Exposure Draft of Phase I of this project as it would represent a change for many insurers.

If you would like further information on any of the matters discussed in this IAS Briefing, please talk to your usual contact at KPMG or call any of our offices.

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