

AEG recommendations on

Employee Stock Options (ESOs)

Status: Final recommendations from the AEG
Website closed for comments

UNSD/ESCAP Workshop on 1993 System of National Accounts Update
19 – 22 April 2005, Bangkok, Thailand

Background

ESOs became increasingly important in the late 90s, especially in North America.

The fall in the international stock markets has reduced the interest for ESOs.

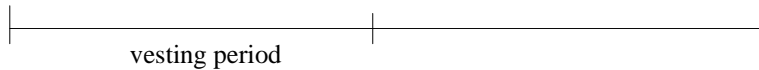
There are no explicit rules for ESOs in the SNA93.

In an OECD meeting on NA in October 2002 there was a broad agreement that ESOs should be recorded as compensation of employees (COE) in the NA.

What is an ESO?

- At the “grant date” a company grants an employee right to purchase a set number of shares at a set price (“strike price”) at a particular time in future.
- The employee must wait for a certain period of time before the options are available for exercise (“vesting period”)
- Usually, one condition is that the employee remains with the company until the vesting date
- The employees exercise the option at their discretion on or after the vesting date by purchasing shares at the strike price

grant date.....vesting date.....execution date



Recording issues

1. Are ESOs part of wages and salaries?
2. When should the ESOs be recorded?
3. How should the ESOs be recorded?
4. What kind of instruments should be used?

Business accounting

Draft IASB proposal (status?)

- Recognize the ESOs as an expense
- Measure the transaction on the basis of fair value of equity instruments granted
- If vesting period, the services are presumed given between the grant date and vesting date
- Fair value measured at grant date using a market value of equivalent traded options or using an option pricing model (Black-Scholes)
- Spreading the costs between grant date and vesting date by the amount of work done.
- No backward revisions

Primary question: compensation of employees?

SNA para 7.21

Compensation of employees is defined as ...the total remuneration, in cash or in kind, payable by an enterprise to an employee in return for work done by the latter during the accounting period.

Recording basis:

Compensation of employees is recorded on an accrual basis; i.e., it is measured by the value of the remuneration in cash or in kind which an employee becomes entitled to receive from an employer in respect of work done during the relevant period, whether paid in advance, simultaneously or in arrears of the work itself....

Timing

Eurostat: vesting date or spreading value at the vesting date across the vesting period

Rationale: fulfill conditions to vest, therefore ESO as contingent asset/liability

(-) Requires revisions

(+) matches the deliveries of services

Valuation

Eurostat: market value or option pricing model at vesting date or difference between ESO strike price and market price of the share at vesting date

IASB: fair value (same as Eurostat) but grant day

More comparability with vesting date ?

Financial accounts

Before vesting date: contingency asset
(no unconditional requirement)

After vesting date: Financial derivative

Others suggest *other accounts receivable/payable*
because there is no risk management involved

Recommendations (1)

The AEG approved the four main recommendations

- The AEG was in favor of showing ESOs as compensation of employees.
- The majority of the AEG members favored spreading the value (at the vesting date) of ESOs between the grant and vesting dates if possible.

Recommendations (2)

- All members of the AEG agreed that the ESOs should be valued at market price, or by using a suitable option pricing model.
- Some members of the AEG expressed reservations with regard to the recording of the ESOs in the financial accounts as financial derivatives. The AEG accepted in principle that an instrument category will be introduced entitled “financial derivatives and employee stock options,” with the subcategories of
 - (1) financial derivatives and
 - (2) employee stock options.

The AEG agreed that the issue paper should be circulated to countries for consultation