Misys plc.

APPENDIX 1

FRED 31 – Share-Based Payment

ASB Question 1

The ASB is proposing to require the adoption in the UK of a standard based on the proposed IFRS from the effective date in the IFRS (which is expected to be accounting periods beginning on or after 1 January 2004). Do you agree with this approach?

We agree with this approach, subject to the issues and concerns raised in our response to the other questions outlined below.

ASB Question 2

The IASB has concluded that its standard should apply to all entities. The ASB does not believe there are any conceptual or practical reasons why that conclusion should not apply equally in the UK. It is therefore proposing that all UK entities, other than those that are applying the FRSSE, should be required to prepare their financial statements in accordance with the proposed standard. Do you agree with this proposal?

We agree that, subject to the issues raised in response to ASB Question 4, the proposed standard should apply to all entities, except those that are applying the FRSSE.

ASB Question 3

The IASB has concluded that its standard should apply to all types of share-based payment transactions, including SAYE-type share purchase plans. The ASB does not believe there are any additional UK considerations that would justify a different conclusion being reached in the context of UK accounting. Therefore, like the IASB the ASB is proposing that the standard should apply to all types of share-based payment transaction. Do you agree with this proposal?

We agree that all types of share-based payment transactions should be included within the scope of this proposal.

ASB Question 4

The IASB is proposing that its standard should apply equally to all individual entity financial statements and consolidated financial statements, regardless of whether for example the reporting entity is a wholly-owned subsidiary of a group that prepares consolidated financial statements or a parent company that also prepares consolidated financial statements. The ASB does not believe there are any additional UK considerations that would justify a different conclusion being reached in the context of UK accounting and is therefore proposing to adopt the same approach as the IASB. Do you agree with this proposal?

We do not agree with the proposal that the standard should apply equally to all entities that issue financial statements, regardless of whether they are wholly-owned subsidiaries.

We believe, given that the shares over which the options exist are those of the ultimate parent, that the ultimate parent, in its consolidated financial statements, should incur the charge for the cost of the options and comply with the disclosure requirements of the proposal. We do not believe that the proposed standard should apply to the solus parent company financial statements where the

parent company complies with the Standard in its group consolidated financial statements. The accounting and disclosures required by the proposed Standard are of primary relevance to the users of the consolidated financial statements.

We agree with the principle that subsidiaries should not be exempt from booking a charge representing the service they receive from their employees in respect of the options granted. However, we believe this should be in the form of an intercompany management recharge and without the full disclosure requirements of the proposed standard.

In our opinion, the disclosure requirements for subsidiaries, where the options are for shares in the ultimate parent, should be similar to those of companies who under FRS 17 – Retirement Benefits, take the multi employer pension scheme exemption. The financial statements of the subsidiary would state that certain employees hold share options in the ultimate parent company and that the subsidiary receives a management charge for the cost of those options. It would then cross-refer to the consolidated financial statements of the entity in whose shares the options are held for full disclosure.

To apply the Standard in full to each subsidiary entity in a Group would lead to an additional administrative burden, with little extra gain.

For example, as indicated in our response to International Accounting Standards Board (IASB) Question 8, we agree that where share options are issued to employees, the service period is considered to be the vesting period. However, during the vesting period the employee may provide a group wide service, run from one entity for the benefit of all. It is our understanding that to apply the standard in full to each entity would require a detailed breakdown of how much each entity was getting the benefit of that service and the appropriate disclosures made.

We believe that our amendment to the proposed Standard would allow an indicative management recharge to be made and limited disclosure in the subsidiary accounts, whilst retaining the full requirements in the consolidated accounts.

ASB Question 5

The ASB is proposing that, when the share-based payments standard is implemented in the UK, the ASB should withdraw UITF Abstract 10 'Disclosure of directors' share options' (if it has not already been withdrawn by then), UITF Abstract 13 'Accounting for ESOP Trusts', and UITF Abstract 17 'Employee share schemes'. It also acknowledges that consequential amendments may need to be made to UITF Abstract 32 'Employee benefit trusts and other intermediate payment arrangements'.

(a) Will these amendments to existing UK requirements be sufficient to enable entities to adopt the proposed standard without being in breach of an existing requirement?

(b) Are any of the amendments unnecessary for this purpose?

We believe that the proposed amendments to existing UK requirements will enable adoption of the proposed Standard without conflicting with existing requirements.

ASB Question 6

The FRED proposes that entities should be required to apply the requirements of the standard to equity-settled share-based payment transactions that were granted after the publication date of the FRED but had not vested at the effective date of the standard. Full retrospective application would not be permitted (unless it can be achieved through early adoption) and nor would prospective application. Do you agree with this proposal?

We do not agree with the proposal in the FRED, which does not permit companies to adopt retrospectively the requirements of the proposed Standard other than through early adoption and covers only those share-based payments that were issued after 7 November 2002 and had not vested at the effective date of the proposed standard.

Under the current proposals any options with a vesting period that began prior to the issue of the FRED would not be included in the retrospective application and similarly any options that completed their vesting period prior to the effective date of the standard, even if issued after 7 November 2002 would not be included.

We believe that such a partial retrospective application will not enable readers of the financial statements to obtain a true and fair view of the cost of share-based payments for several years after implementation. This will, in our opinion, devalue the impact of the Standard until such time as companies have built up a 'normal' full year's charge in the comparative period. Given that share based payments to employees are seen by companies as a means of retention, it is possible that some schemes will have vesting periods of up to seven years, in particular Save As You Earn (SAYE) schemes. This is the period of time over which the standard will effectively be phased in.

Furthermore, the proposed Standard gives no guidance to the users of financial statements as to when the earnings statement will show a 'full' charge and thus comparability between years and between entities.

The consequence of this is that the services being received in the current and comparative period will not be matched by a relevant charge in the company, which is the basis of the argument that the ASB has used for bringing forward the proposed Standard.

Full retrospective application in year one will ensure that the profit and loss account will immediately show a 'full' charge and reflect the services received during that period. It will also ensure that the prior year information is fully comparable. However, it will be extremely difficult for companies to calculate the required adjustment to opening reserves and thus we do not believe this is a feasible option.

We therefore believe that the retrospective application should include all options in issue yet to vest at the beginning of the comparative period on adoption of the Standard. The adjustment to opening reserves in the comparative period would therefore only be the charge that would have previously be made on those options still in their vesting period. It would not require companies to adjust retrospectively opening reserves for options that had completed their vesting period.

This would result in a comparable profit and loss account charge in the comparative period, the current period and all subsequent periods. To ensure comparability, we believe that this should be mandatory for all quoted companies and recommended for all other entities.

In the event that sufficient information is unavailable to allow the necessary retrospective application, then delaying the implementation date beyond 1 January 2004 to enable companies to gather the necessary information, has many merits. Not only will this enable a 'true' charge to be posted in the year of implementation, but will allow time for accepted practices to develop in relation to the estimates used in the option pricing model, as outlined in our response to IASB Question 11. We would argue that in the intervening period, the transitional arrangements would require disclosures in the financial statements, similar to the transitional requirements of FRS 17 – Retirement Benefits.

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?

We agree with the proposed scope of the Standard in principle, subject to the issues and concerns raised in our response to ASB Question 4.

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?

We believe the proposed recognition requirements are 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?

We agree that this measurement principle is appropriate.

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?

We do not agree that the date at which to measure the fair value of goods and services is necessarily the date at which the entity obtains the goods or receives the services.

In our opinion, the date at which to measure the fair value of the goods and services is the date at which the consideration is agreed which, we believe, is likely to be grant date and therefore consistent with the measurement approach for share based payments to employees.

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?

We agree with the principle of using the grant date as the date at which to measure the fair value of the equity instruments granted.

However, we believe that the fair value of the equity instruments granted should be 'trued up' during the vesting period to reflect the up-to-date estimate of the likelihood of the performance conditions being met. The final charge should represent the cost of all equity instruments vesting together with any that would have vested had they not been cancelled by the company. This is an argument that is expanded in detail in our response to IASB question 24.

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?

We agree that the fair value of the goods received is usually more readily determinable than the fair value of the equity instruments granted.

However, we do not believe that this is necessarily the case for all types of services received. For example, equity based options have been used as consideration for services received in relation to start up companies, where the service provided is bespoke to that company. The fair value of this service may not be readily determinable. In our opinion the draft Standard should replace the rebuttable presumption with the phrase 'more likely' in relation to the fair value of services received.

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 is not so?

We agree that the fair value of the equity instruments granted is more readily determinable than the fair value of the employee services received.

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?

In our opinion, where equity instruments are issued in return for services there should be a rebuttable presumption that the vesting period covers the period during which the service is received and that the profile of recognition during this period should reflect the specific circumstances of the services provided which will not necessarily be straight line during this period.

We consider that the current proposal is too prescriptive and could result in an inappropriate profile of the charge during the vesting period. For example, it would not be unusual for there to be a 'retention' type period at the end of the receipt of the service included within the vesting period. During this period no further service is received but it allows the customer to assess whether the service previously provided meets the pre-designated requirements. Given that no additional service is received, we do not believe it is in the spirit of the proposed Standard that a charge should be made to the profit and loss account during this period.

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?

We agree that the unit of service method appropriately estimates, rather than attributes, the fair value of the equity instruments granted to each unit of service received.

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 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?

As we outlined in our covering letter and in response to IASB question 24 we do not agree that there should be no subsequent adjustment to total equity in the event that equity instruments granted do not vest.

In our opinion, although the company may have received the service for which an equity instrument was granted, it is likely that once it is clear that the performance conditions will not be met and the instrument does not vest then any service has effectively been received at no additional cost to the company. Therefore, the company should adjust the cost that has been accrued during the vesting period to reflect the actual number of equity instruments vesting or would have vested if they had not been cancelled by the company. These arguments are further expanded elsewhere in this response to FRED 31.

The IASB points out that the proposed Standard does not preclude an entity from recognising a transfer within equity. However, we believe that it would be helpful if, in the final Standard, the ASB were more explicit and offered greater guidance on how the reserves/equity accounting should be undertaken, particularly on whether these reserve movements will impact distributable or non-distributable reserves.

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?

We agree that an option pricing model should be applied to estimate the fair value of options granted and that it is appropriate to take into account the factors listed above in applying an option pricing model. We would also add delayed vesting to the list of factors.

Given the inherent difficulties of this valuation approach, if there is an alternative, credible and comparable measure, which can be demonstrated to be more accurate, the Standard should permit this to be used.

We would expect that with experience, a generally accepted best practice approach will emerge on how to take account of these factors, although this process will take time and experience. In order to encourage the adoption of best practice as it emerges (rather than stick with second best alternatives) we would we would suggest that there is a period of two or three years during which the information on accounting for share-based payments is only provided in the notes to the accounts.

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?

We agree with the approach proposed in paragraphs 21 and 22 of the proposed Standard.

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?

We agree in principle with the approach that is currently proposed to take into account vesting conditions when estimating the fair value of options or shares granted.

However, if the current proposals were amended to allow retrospective adjustments and a ‘truing up’ of the charge, as we have argued in response to IASB question 24 and elsewhere in this letter, then the issue of taking into account vesting/performance conditions at the outset would become less critical and subjectivity in this aspect of the charge would be removed.

Despite the issue then being of less importance overall, we believe that an accurate assessment of the vesting conditions throughout the vesting period will ensure a more accurate charge throughout the vesting period, reduce any ‘truing up’ adjustment and reduce the volatility of the profit and loss account as a result of these proposals. As a result, we would suggest that this should be deemed ‘best practice’.

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?

We agree with the treatment in the proposed Standard.

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?

We are not aware of any common features of employee share options that have not already been taken into account.

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?

We agree with this approach and, subject to issues and concerns raised elsewhere in this document, we are not aware of any specific aspects of valuing options for which prescriptive guidance should be given.

IASB Question 17

If an entity re-prices 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 re-pricing, 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 to the draft IFRS illustrates this requirement. As shown in that example, the incremental value granted on re-pricing 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 re-pricing should be dealt with? Of the two methods illustrated in Example 3, which is more appropriate. Why?

We agree with the principle outlined in the proposed Standard that, when an entity issues a re-priced option, the incremental value of the re-priced option should be recognised over the remainder of the vesting period. However, we do not agree with the method currently proposed for calculating that incremental element.

The FRED suggests that the original grant should continue to be charged over the vesting period. In addition, the incremental element, between the fair value of the original grant at the date that the re-priced options are issued and the fair value of the re-issued options, is also charged to the profit and loss account, over the vesting period of the re-priced options. We believe that the two elements of re-pricing, the cancellation of the original option and the new option, should each be accounted for on a stand-alone basis.

In our opinion, the remaining charge for the original options should be based on the net of the original fair value and the fair value on cancellation, less the amount charged to the P&L to date. That amount should be debited/credited in the profit and loss account as at the date of cancellation, rather than continuing being charged to the profit and loss account throughout the

original vesting period. The new, re-priced, option would then be accounted for as if it was a stand-alone option.

This is best illustrated with an example. If the original option had an estimated fair value of £20 per option, that charge would continue throughout the vesting period. However, after two years of the four-year vesting period the options are cancelled and re-priced options issued. At that moment the fair value of the original options is £4. The total cost to the company of those options is therefore £16 (£20 – £4). Given that £10 has already been charged to the profit and loss account in the first two years of the vesting period, on cancellation there is a final charge of £6.

New, re-priced, options, with a vesting period of two years, are issued with an estimated fair value of £20. The charge to the profit and loss account would be £10 per annum. In total there would be a profit and loss account charge of £36. This is consistent with the charge under the method proposed in the FRED but we believe that this method produces a more appropriate charge profile.

We believe that the above proposal is intellectually more coherent than that proposed in FRED 31 because it recognises that compensation to the option holder, for the cancellation of the original option, may not solely be in the form of cash or a re-priced option. Our proposed treatment is quite consistent with the scenario where compensation is not in the form of a repriced option and therefore adheres to the IASB approach of ensuring the standard is principles based rather than prescriptive.

In addition, at the date at which the cancelled options were due to vest, the profit and loss account charge would still need to be 'trued up' to reflect the actual number of instruments that would have vested had they not been cancelled by the company. This is consistent with our belief that 'truing up' for performance conditions will discourage manipulation of the estimates at grant date. This is an argument that is expanded in detail in our response to IASB question 24.

We believe the above approach is preferable to either of the two methods illustrated in Example 3 of Appendix B in the draft IFRS.

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.

We do not agree with the proposed treatment for shares or options granted that are cancelled during the vesting period. In our opinion the reason for continuing to have a charge for an option that has been cancelled is not intellectually coherent.

As discussed in our response to IASB Question 17, it is our opinion that, once an option has been cancelled, the relationship that this brought between the company and the option holder has ceased and any remaining charge or excess charge should be accounted for at that time. This charge, or credit, would be the difference between the fair value at grant date and fair value at cancellation date less the charge previously incurred. Any compensation for the cancellation would be accounted for by reference to the nature and any related conditionality of the compensation.

Furthermore, in our opinion, the approach adopted by SFAS 123 in relation to the cancellation of equity instruments has some merit. Under SFAS 123 the company undertakes a 'truing up' on cancellation, of an option granted, during the vesting period. However, we believe that this 'true up' should take place periodically up to the original vesting date, as only then is it finally possible to assess whether the performance estimates made at grant date were accurate.

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.

We believe that the proposed requirements are appropriate.

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.

In our opinion, the proposed requirements are 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)?

We agree in principle that disclosure requirements are necessary, to enable the reader of the financial statements to understand the impact that the accounting for share-based payments has had on a company and the extent and nature of those arrangements.

We therefore agree with the proposed disclosure requirements outlined in parts (a) and (c) of the question. However, we have significant reservations about the disclosure requirements of part (b).

The proposed Standard requires disclosure of the factors used in determining the fair value of the options, as well as the likelihood of meeting any performance criteria of the option and leaver rates. Some of these disclosures will be price sensitive. For example, one common performance criteria is a designated company growth rate. In this case it is not appropriate, in our opinion, to disclose managements' prediction of expected growth for the duration of the option, which could be a number of years. If the company is required to 'true up' during the vesting period this disclosure would become less relevant to the reader of 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 (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 believe that the proposed requirements are appropriate. In our opinion, partial retrospective application should include all options in issue at the beginning of the comparative period of the effective date of the Standard. Furthermore, we recommend that this should be mandatory for all quoted companies and recommended for all other entities.

A full discussion of the merits of this approach and the reasons why we do not believe the current proposals are appropriate can be found in response to ASB Question 6.

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?

We believe the proposed requirements are appropriate.

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;
- SFAS 123 encourages, but does not require, entitles 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; and
- 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.

As an observation, we agree that, as far as is practicable, the IASB should try to converge accounting standards around the world. We support the idea that, where existing standards do not provide coherent and effective guidance, the IASB should lead the way with new methodologies.

We agree that the differences outlined above are correctly treated in the proposed FRED, subject to the considerations outlined elsewhere in this letter.

(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.

- 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.

The current scope of the Standard requires an entity to charge to the profit and loss account a fair value charge based on an option pricing model and management assumptions. As our response to question 11 indicates, we are in agreement with this approach. However if the options would not have vested the company would not have incurred any cost associated with that equity instrument, yet there will have been a charge through the profit and loss account throughout the vesting period on the assumption that the equity instruments would have vested.

Under SFAS 123, in these circumstances, the company is permitted to 'true up' the costs associated with its share-based payments by reversing the previous charge on lapsed equity instruments.

Whilst we recognise that the proposed Standard enables management to take into account an estimate of potential lapsing due to failing to meet performance criteria when estimating the fair value at grant date, there is currently no provision in the FRED for revising this and 'truing up' either on an ongoing basis or at the date of vesting.

We believe that enabling companies to 'true up' on vesting for performance conditions will discourage the manipulation of estimates at grant date on the likelihood of meeting performance criteria. Furthermore, initial estimates are unlikely to be entirely accurate due to the inherent difficulties associated with making these estimates. Any under or over estimate would be accounted for at the time of 'truing up'. The 'truing up' would not apply to any equity instruments that did not vest solely because it was cancelled prior to vesting.

In addition, we believe that it is important that all balances within the financial statements should represent a valid item. If 'truing up' is not permitted then the 'Other Reserves' balance will ultimately not represent anything other than the net, cumulative, unders and overs charged to the profit and loss account.

(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.

We believe, as detailed in our response to IASB Questions 17 & 18, that the cancellation of an option and the accounting for any related compensation should be accounted for separately. Accordingly, we do not agree with either SFAS 123 or the draft IFRS on this point.

(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.

We agree that the differences outlined above are correctly treated in the proposed FRED, subject to the considerations outlined elsewhere in this letter.

(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.

We agree that the differences outlined above are correctly treated in the proposed FRED, subject to the considerations outlined elsewhere in this letter.

(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.

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.

We agree that the differences outlined above are correctly treated in the proposed FRED, subject to the considerations outlined elsewhere in this letter.

IASB Question 25

Do you have any other comments on the Exposure Draft?

We believe that there are two areas, in relation to share-based payments, that are not adequately covered in the proposed standard.

As noted in our response to IASB Question 10, we believe that further clarification and guidance is required on the treatment of equity/reserves in relation to the proposals. In addition, we believe that further guidance is required from the ASB on whether this charge impacts distributable or non-distributable reserves.

Secondly, at present we hold our own shares within "investments" on the balance sheet for the purpose of satisfying a number of options. We would welcome guidance on the accounting treatment under the proposed Standard. Under IAS a 'Treasury Shares Reserve' is used, although this is not mentioned in the proposed Standard.

We request that the ASB provide some explicit guidance in the standard to cover these arrangements.