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GROUP OF 100 Inc.

ABN 83 398 391 246

The Group of 100 is an association of senior accounting and finance executives representing the major public companies and government owned enterprises in Australia.

National Secretariat
Level 28, 385 Bourke Street
Melbourne, Victoria 3000
Telephone: (03) 9606 9661
Facsimile: (03) 9670 8901
Email: g100@group100.com.au

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Sir David Tweedie

Chairman

IASB
30 Cannon Street
London ED4M, 6XH
UNITED KINGDOM

Dear Sir David

ED 2 'Share-based Payment'

The Group of 100 is pleased to provide comments on ED 2 'Share-based Payment".

While broadly supportive of the proposals the Group of 100 is concerned about:

- The practical implications of implementing the requirements to amortise service cost to reporting periods. We believe that the standard should state a principle and that the entity determine the most appropriate approach for measuring the amount of periodic expense: and
- The extent and detail of the proposed disclosures.

Yours sincerely,

John Stanhope
National President

C.C Mr K Alfredson AASB

GROUP OF 100

ED 2 SHARE-BASED PAYMENT

QUESTIONS RAISED IN IASB ED 2 'SHARE-BASED PAYMENT'

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?

The G100 agrees *with* the scope of *the proposed standard.*

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?

The G100 supports the requirements. However, it is *presumed that an asset is recognised (prepayment) when equity instruments are issued in advance of the services being received.*

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?

The G100 supports the measurement principle. However, we suggest that the fair value of the equity instruments issued should be given primacy. However, we are concerned that the determination of the fair value of the equity instruments issued takes no account of the factors such as the size of the parcel of shares or other characteristics such as whether it confers control of another entity.

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?

The G100 believes that the fair value of the transaction should be measured on the date the two parties agree the value of the exchange and control passes from one entity to the other, that is the date of acquisition.

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 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?

   The G100 *agrees that the fair value of the equity instruments granted should be measured at the grant date. Where grants are made to different employees at different but relatively close dates it is suggested that, on grounds of practicability and to minimise the extent of valuations needed, entities be permitted to measure fair value on the offer date.*

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 is not so?

   The G100 agrees with the existence of a rebuttable presumption but considers that the exchange should be measured on the basis which is more readily determinable and reliable.

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 are circumstances in which this is not so?

   The G100 believes that this would depend on the way in which an employee's total remuneration is determined. For example, remuneration may be expressed as an aggregate amount and the value of share-based compensation determined as a residual which will not necessarily correspond to the fair value of the services rendered or the fair value of the equity instruments granted.

   We believe that there is a presumption that the fair value of the equity instruments is more readily determinable but that this is not a general rule. The approach adopted should be consistent with that applying in other circumstances such as those dealt with in paragraphs 9 and 10.

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?

No. The G100 believes that the services may have been rendered in a previous period or that the consideration may relate to both past and future services.

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?

The G100 believes that the standard should specify the objective of the process of determining the periodic expense in terms of a principle and that the method of allocation be determined by the entity as one that best reflects the pattern of consumption of the services acquired. Such an approach would be consistent with that applied when determining depreciation of plant and equipment.

In some cases the units of service method may be appropriate while in others a straight-line allocation may be appropriate. In other cases an entity may determine that the periodic cost of equity instruments granted should be recognised as an expense. For example, where an entity has a large number of employees in a plan and there are low levels of staff attrition, the units of service method is likely to add a further level of judgement in applying the requirements, increase the burden of record-keeping required and is unlikely to generate a materially different outcome than the application of a straight-line method of allocation.

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 in 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. 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 G100 believes that the transaction should be measured at the date of acquisition and should not be remeasured subsequently.

We consider that where options are granted and are not exercised it would appear that the cost to the entity of the services received has been overstated and that reported earnings has been understated.

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?

The G100 agrees that where market prices are not available an option pricing model should be applied to determine the fair value of options granted taking account of performance hurdles etc.

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 options 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?

The G100 agrees with the proposed requirements.

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. If 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?

    Vesting conditions are an integral part of certain option and share schemes and as such should be taken into account in the measurement process. The manner in which this is done should not be specified but left to reflect the circumstances and environment in each case. We suggest that further guidance in determining the vesting period would facilitate practical application, particularly where there are multiple vesting periods.

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?

    The G100 agrees with these proposals.

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?

    The proposals appear to identify the most common features. However, the standard should state the principle that the features/terms of options granted are taking into account in determining their fair value (see question 13).

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?

The G100 agrees with the approach not to mandate a measurement methodology. We believe that the major issue at this stage is to achieve recognition of options and that entities be able to experiment and identify appropriate reliable measurement approaches consistent with the valuation principles in respect of their schemes.

Entities should be encouraged to develop methodologies consistent with the principles and to disclose the method(s) adopted. If the outcome of this approach is significant and unacceptable variability in approaches the more specific guidance, on the basis of implementation experience, could then be provided.

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 of 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 s more appropriate? Why?

The G100 agrees that repricing of options should be measured on the basis of changes in incremental value and applied prospectively over the remainder of the vesting period. We believe that the averaging approach illustrated in Example 3 provides a better reflection of the value of the services consumed by the entity over the remaining period of the option scheme subsequent to a repricing which included an extension of an existing scheme rather than create a new scheme.

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 provide details of your suggested alternative approach.

The *G100 does not support this proposal. To continue to account for a scheme which no longer exists appears to be artificial. However, where a scheme is cancelled it is likely that some compensation would be made in respect of the variation/breach of contract with the employees and that cost should be charged to the periods in which the services are consumed.*

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.

The G100 supports these proposals which are consistent with that adopted in respect of measuring foreign currency liabilities.

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.

The G100 supports these proposals.

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)?

The G100 supports the disclosure principles as outlined in paragraphs 45 and 47 but has serious concerns about the extent and detail of the disclosures. The objective of the disclosures should be to provide users information to understand how amounts are determined and not repilcate the measurement process.

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 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 IFRSs transitional provisions.

The G100 supports the transitional arrangements.

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?

Yes