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**Office of the Director of Finance**
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**31 January 2003**

International Accounting Standards Board
30 Cannon Street
London EC4M 6XIT
UNITED KINGDOM

Mr. Keith Alfredson
Chairman
Australian Accounting Standards Board
P0 Box 204
Collins Street West, Melbourne 8007

Dear International Accounting Standards Board and Mr. Alfredson

**IASB ED 2 Share-based Payment**

Telstra is pleased to have the opportunity to provide our comments to both the International Accounting Standards Board and the Australian Accounting Standards Board.

We welcome the development of an international accounting standard dealing with the accounting for share-based payments. We believe that a global approach to such an important issue will be beneficial to entities of all jurisdictions.

**General Comments**

In general we are in favour of the majority of the draft IFRS however we believe more guidance is required in the following areas:

- accounting for a situation where an entity purchases shares on market and holds these on trust for later distribution subject to performance hurdles and other vesting requirements (the trust may or may not be controlled). This may involve the payment of an exercise price to the trust for certain instruments;
- accounting for loans granted in relation to share based payment transactions; and
- accounting where a controlling or other shareholder grants shares to employees of the entity as a result of a sale of equity by the controlling or other shareholder.

In some cases, we have also suggested different approaches to those suggested in the draft IFRS. For example:

- expensing all share based payment costs up front in line with an entity's remuneration practices; and
- using offer date as measurement date for schemes involving a range of time for acceptance of the terms of share based schemes.

We also believe that:

- the amounts recorded as expenses under the final IFRS should match the disclosure requirements for directors' and executives' share based remuneration; and
- the disclosure requirements are onerous and could be overly complex, thus jeopardising their usefulness to the users of the financial statements.

Please find our response to the specific questions you have raised in the following attachment. If you need clarification on any of these issues please contact me at the address above.

Yours sincerely

John Stanhope
Director Finance
**Telstra Corporation Limited**

**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?***

Generally, we agree with the IFRS proposal to cover all equity based payments (whether cash settled or equity settled).

However, we also believe that the scope should specifically mention that this draft IFRS covers all equity transfers made in equity-settled share-based payment transactions. This should be the case regardless of whether the shares, options or equity instruments are <u>freshly issued</u> or <u>purchased on market</u> and either transferred directly to the third party at the time of purchase or held in a trust (trust may be controlled or not controlled), to be transferred to the third party at a later date.

We also suggest that clear rules be incorporated in the draft IFRS to account for equity based payment transactions where the entity purchases the instruments "on market" instead of issuing fresh equity.

Furthermore, the exceptions covered by paragraph 3(b) should be more clearly identified so that the users of the standard can easily identify the type of exception, and whether they need to read IAS32 or IAS39 [revised] in more detail.

**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?***

Telstra believes that the recognition requirements are appropriate, however as described in Question 1, we believe that further guidance is required regarding the accounting for equity instruments purchased "on market" for the purpose of satisfying equity settled share based payments.

In some circumstances it may be difficult to identify when an employee performs their services in return for equity based share payments. In such cases the entire expense in relation to the grant of the equity instrument should be recognised immediately on grant.

For example the decision to grant equity instruments in year 1 may be based on a certain % of an employees remuneration contract. Where this is the case the employee is receiving non-cash remuneration in that year and as such the entity should recognise an expense for the services received in that year. This should be the case despite the fact that the term of the equity instruments may be over a number of years and may contain a number of hurdles.

Therefore, we believe that where employee remuneration contracts entitle them to receive share based payments as part of a company sponsored scheme **every year**, then the entity has "consumed the services of the employee" in that year. For example say an equity instrument has an effective life of 4 years. Under the draft IFRS in year 3 we would be required to recognise *25%* expense of the year 1 grant fair value, *25%* expense of the year 2 grant fair value and *25%* of the year 3 grant fair value. However in practice each year is treated as mutually exclusive for remuneration purposes.

Another issue we have with the draft IFRS is that if equity instruments are granted say 1 month prior to year end, the entity will not recognise the costs of those instruments until future year ends. However as mentioned above each year is a separate remuneration year (from the perspective of both the employee and employer) and it is difficult to "allocate" costs over future periods when new instruments are continually being issued in those future years.

**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?***

Generally we agree with the "no exceptions" rule for measuring share-based payments at fair value. However, we also believe more guidance is required in the following circumstances:

- where shares are purchased "on-market" and held in trust subject to performance hurdles. The shares will be purchased at different times to the period of vesting and period of services received from the employees; and
- simplistic models should be specified for unlisted entities as the cost involved in obtaining a formal valuation each time the entity issues equity instruments would be prohibitive. For example they should be allowed to use a simple net asset model adjusted for performance hurdles.

**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?***

When using the "direct" method, the date to measure the fair value of the goods or services received should be the contract date. When using the "indirect" method, grant date should also be the same as contract date as the contract would specify the number of equity instruments to be issued in return for the goods or services. Even though on contract signing, the goods or services may not have yet been delivered or provided, contract signing does provide a more fixed and determinable reference date.

We believe that the dates to measure fair value should not be different when using either the "direct" or "indirect" method. The date of contract signing should be used for the direct method as this equates to the grant date for the indirect method.

**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? U not, at which date should the fair value of the equity instruments granted be measured? Why?***

We agree that the grant date should be used as the measurement date for equity-settled share-based payment transactions. However where employees are offered share based payment schemes as part of their remuneration package, employees may accept the terms and conditions at various dates. For practical reasons a single date needs to be selected as we would not want to have to get numerous valuations to comply with the draft IFRS. Therefore, in these circumstances the <u>offer date</u> for the purposes of the draft IFRS should be deemed the grant date for measurement purposes.

**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 with the rebuttable presumption, but the exchange should be measured on the basis which is more readily determinable and reliable.

However, more guidance is required in the area of the appropriate fair value where suppliers of goods and services use discounts and special offers, including further discounts for product bundling and early payment discounts etc. Therefore the guidance needs to be clear as to whether the goods or services should be measured separately (where multiple goods and services are involved) and whether discounting from normal market pricing is allowed and under what circumstances (eg. volume, special customer, price matching and negotiation, early payment, etc).

**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?***

When dealing with employee services, we agree with the draft IFRS that the fair value of the equity instruments granted is usually more readily determinable than the fair value of employee services received. Some entities may allocate a certain amount or percentage of remuneration towards equity based share schemes, however without fair valuing the instruments that are granted to the employees, the entity has no way of determining the value that it has transferred to the employee. While we believe that there is a presumption that fair value of the equity employee instruments is more readily determinable, the approach adopted should be consistent with that applied in paragraphs 9 and 10.

**Question 8**

***Paragraphs 13 and 14 of the draft IFRS propose requirements for determining when the counter party renders service for the equity instruments granted, based on whether the counter party 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 counter party as consideration for the equity instruments are received during the vesting period? If not, when are the services received, in your view?***

No, we do not agree that is reasonable to presume that the services rendered by the counterparty as consideration for the equity instruments are received during the vesting period.

Where employees have remuneration contracts that entitle them to receive share based payments as part of a company sponsored scheme every year, then the entity may have "consumed the services of that employee" in that year. For example say an equity instrument has an effective life of 4 years. Under the draft IFRS in year 3 we would be required to recognise 25% expense of the year 1 grant fair value, ***25%*** expense of the year 2 grant fair value and 25% of the year 3 grant fair value. However, in practice each year may be treated as mutually exclusive for remuneration purposes. Consideration given could also relate to both past and future services.

Another issue we have with the draft IFRS is that if equity instruments are granted say 1 month prior to year end, the entity will not recognise the costs of those instruments until future year ends. However as mentioned above each year is a separate remuneration year (from the perspective of both the employee and employer) and it is difficult to "allocate" costs over future periods when new instruments are continually being issued in those future years.

Therefore on our view for equity based payment transactions should be accounted for as follows:

- for employees - the full fair value should be expensed on grant date as we believe the services are received on grant date as part of the employees remuneration package.
- for suppliers - this would need to be assessed on a case by case basis. For example it may be appropriate to defer and amortise the fair value of the services over a number of reporting periods as the services delivered cover a number of reporting periods.

The issue of director and executive remuneration disclosures must also being given consideration. These disclosures would need to be consistent with what is expensed through the accounts of an entity. Otherwise the numbers of equity instruments granted to an executive in any particular year will not match the cost of the instruments disclosed against that executive, and will not match the cost of the employee's service for the year being disclosed.

**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? U 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? U not, what alternative method do you propose?***

To make the accounting simple and understandable to all preparers and users, we believe that the fair value of the equity instrument should be expensed in full at the date of grant. As the calculation of the fair value equity instruments is already complex and based on estimates and assumptions, we believe that expensing up front is preferable to allocating over units of service. This is because the fair value of the instrument can change from period to period and allocating a fair value at a point in time over a number of years does not make sense from an economic or time value of money sense. We can estimate forfeiture at the data of grant. We should not then need to assess actual employees left in the scheme after this date. If we need to start tracking each plan, year after year, half year after half year according to numbers of employees this will be an extremely complex exercise. Not to mention the fact that for management accounting purposes, these complex calculations will need to be performed on a monthly basis. The expense produced each month and the fluctuations that occur from month to month will not be understandable to users of the financial statements. We will also not be able to take the expense numbers produced and match them against individual directors and executives for the purposes of disclosing director and executive remuneration as the amounts concerned will not make any sense.

We believe that the fair value of an equity instrument should be determined on grant date and adjusted for probabilities for non performance of hurdles, non vesting and retention, all determined on the date of grant. This number should then be expensed based on the total number of options granted. No further adjustments should be made. This will result in a simple and understandable method of accounting for these complex instruments.

If an entity was required to determine the amount to attribute to each unit of service received, we believe that this should be calculated by dividing:

the total fair value of all equity instruments determined on grant date and adjusted for probabilities for <u>non performance of hurdles, non vesting and retention, all determined on the date of grant; by</u> the total number of employees

This amount is then divided by the option life (or expected option life) and amortised on a straight line basis over the option life. No further adjustments are made for changes in employment numbers, hurdles or other forfeiture's. However as stated we would prefer to expense the full fair value up front at the date of grant.

**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, ie 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?***

Yes, we agree with the proposed requirement of not making any subsequent adjustments to equity, even if the equity instruments granted do not vest or the options are not exercised. The risk of non vesting should be taken into account when determining the fair value of the equity instruments granted. In addition, if an entity so chooses, we agree with the proposed allowance of transferring amounts from one component of equity to another subject to taxation and corporations' laws in each jurisdiction.

**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? U 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 used to estimate the fair value of the options granted. The resulting value should then be adjusted for probabilities for not meeting hurdles, resignations, other forfeiture's, and any other special characteristics that are unique to the option.

**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?***

Yes, we agree with replacing an option's contracted life with its expected life when applying an option pricing model as that is an appropriate means of adjusting the option's fair value for the effects of nontransferability.

We also believe the proposed requirement for taking into account the inability to exercise an option during the vesting period is appropriate. We believe a percentage adjustment to the option price is the most appropriate way of adjusting for the inability to exercise during the vesting period where appropriate.

**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 with the proposal that vesting conditions should be taken into consideration when calculating the fair value of options or shares granted. Vesting conditions are now an integral part of most option and share schemes and as such should be taken into account in the measurement process. We believe a percentage adjustment to the option price is the most appropriate way of adjusting for the fact that vesting conditions exist. We should not be making the option pricing models overly complex. Once we have an option value, only simply percentage adjustments should be made to this value to adjust for vesting conditions, such as performance hurdles.

**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 this proposal, however we suggest that the glossary in the draft IFRS be amended to define more clearly a reload feature.

**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 have not identified any other features of employee share option schemes for which the draft IFRS needs to specify specific requirements, apart from:

- The situation where an entity purchases shares "on-market" and holds them either in trust or directly as a pool of instruments to allocate to employees at future dates subject to performance hurdles and other vesting conditions. Additional guidance is required regarding the treatment of the shares acquired and how these should be combined with the fair value of the options granted and expensed to the statement of financial performance;
- The treatment of any loans made to employees of employee share scheme trusts in respect of the grant of equity instruments or shares; and
- The treatment of shares allocated to employees by controlling or other shareholder as part of the sale of equity by a controlling or other shareholder. This may also involve interest free loans granted to employees by the entity.

**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 the objective of setting principles-based requirements with regards to estimation techniques used to calculate the fair value of options.

**Question 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 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? U not, how do you suggest repricing should be dealt with? Of the two methods illustrated in Example 3, which is more appropriate? Why?***

We believe that any incremental value generated from the repricing or modification of any terms and conditions of any options should be accounted for as an expense on the date of modification. The incremental expense should be based on the number of options alive on the date of modification, not based on the original number of options granted.

If we needed to choose between the two methods illustrated in example 3, we would choose the first method.

However, if we cannot expense the entire incremental value on the date of modification, we believe that a simpler approach as identified in Question 9 is also appropriate for allocating the incremental cost (ie. On a straight line basis over the remaining expected life of the option).

**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 counter party 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 believe that the full amount of equity instruments granted should be expensed in full on grant date. This will remove the problems associated with an entity cancelling the equity scheme after grant date.

However, if the new IFRS does not allow expensing of the full cost on date of grant we do not believe the entity should continue to expense the remaining cost of the cancelled options.

We also agree with the proposed requirements for dealing with any payment made on cancellation and/or a grant of replacement options, and for the repurchase of vested equity instruments.

**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 agree with the draft ]FRS approach in remeasuring the fair value of a cash settled share-based liability at each reporting date. However the draft IFRS needs to be very clear where the other side of the adjustment is accounted. For example should the other side of the entry be booked against the cost of the good or service acquired or should the cost go against a "cash settled share based payment expense and/or revenue account. We believe that the adjustment should go against a cash settled share based payment expense and/or revenue account as we would not want to be making adjustments to asset values or specific expense lines in subsequent reporting periods.

**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? U not, please provide details of your suggested alternative approach.***

We agree with the proposed requirements outlined in the draft IFRS.

**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)?***

Telstra supports the disclosure principles outlined in paragraphs 45 and 47. However, we believe that the detailed disclosures proposed in the draft IFRS are onerous and for companies that issue two or more new equity schemes to employees each year with long term vesting conditions, will result in pages and pages of information. The objective of the disclosures should be to provide users with information to understand how amounts are determined and not to replicate the measurement process within the financial statements.

The imperative must be to avoid developing overly complex disclosures concerning the fair value calculations that are difficult for users of the financial statements to understand.

**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 (ie the amount that would have been paid on settlement of the liability had the counter party 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 agree with the transitional provisions in the draft IFRS However, where employees are offered share based payment schemes as part of their remuneration package, employees may accept the terms and conditions at various dates. For practical reasons a single date needs to be selected as the "deemed" grant date as we would not want to have to get hundreds of valuations to comply with the draft IFRS. Therefore, in these circumstances the offer date for the purposes of the draft IFRS should be deemed the grant date for measurement purposes. The offer date should also be used for the transitional cut-off date.

**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 agree with the proposed requirements as outlined in the draft IFRS. The draft IFRS should take into account that for some countries there are no taxation consequences involved with the issue of options. Entities may also purchase shares on trust for later grant to the employees. As there may be many permutations and combinations involved with the tax effect of share based payment transactions, we believe only the general principles should be included and not specific examples. Alternatively, the general example should be clearly titled "general example" and that there may be different taxation consequences in different jurisdictions, which would need to be accounted for in accordance with the general principles.

**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, entities 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 (paragraphs BC70-BC74 in the Basis for Conclusions give an explanation of intrinsic value); 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 (paragraphs BC75-BC78 in the Basis for Conclusions give an explanation of minimum value).***

***(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.***

***(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.***

***(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.***

***(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 (refer to paragraphs BC7O-BC81 of the Basis for Conclusions for a discussion of intrinsic value, time value and fair value).***

***(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 (Respondents may wish to note that further details of the differences between the draft***
***IFRS and SFAS 123 are given in the FASB's Invitation to Comment)***

With regards to the differences identified in (a) above, we believe that:

- the draft IFRS should not contain any exemptions as we need a standard that is as comprehensive as possible.
- We disagree, however, with the IASB’s approach regarding unlisted entities. We believe that the minimum value method should be allowed for unlisted entities so that the calculations used by these entities are as simple as possible and cost effective to produce.

With regards to the differences identified in (b) above, we believe that:

- forfeiture should be allowed to be adjusted when determining fair value up front in accordance with the draft IFRS.
- However, further to this, we believe that all forfeiture allowances should be determined and locked in up front so that there is no need to track actual forfeiture’s in future years. This will simplify calculations and will not be costly to implement.

With regards to the differences identified in (c) above, we believe that:

- if the grant of equity instruments are settled early during the vesting period in cash, we believe that the FAS 123 method is more appropriate as this signals an end to the scheme and should not be carried over to subsequent reporting periods.

With regards to the differences identified in (d) above, we believe that:

- the date of contract signing should be used as the measurement date as this is the date that both parties have agreed to deliver both parts of their respective contributions. We do not believe that the date performance is completed is appropriate as this is not the date the parties have initially agreed to the transaction terms and conditions.

With regards to the differences identified in (e) above, we believe that:

- the fair value approach identified by the draft IFRS is more appropriate as this is the amount that will ultimately need to be settled in cash. However we believe the draft IFRS needs to specify where the revaluation of the liability is recorded. As suggested in question 19, We believe that the adjustment should go against a cash settled share based payment expense and/or revenue account as we would not want to be making adjustments to asset values or specific expense lines in subsequent reporting periods.

With regards to the differences identified in (f) above, we believe that:

- the treatment identified in the draft IFRS is more appropriate as equity should not be reduced for ordinary taxation consequences of issuing share or options. We do question the amendment of IAS12 as mentioned in question 23 as not all jurisdictions will have tax consequences associated with the grant of options or shares. Therefore caution needs to be taken when providing examples of how to tax effect for all situations involving equity based payments.

**Question 25**

***Do you have any other comments on the Exposure Draft?***

We have included general comments at the start of our submission.

## AASB Additional Matters for Comment

***(a) whether the proposed interim restriction of application to share-based payments for employees (until the Australian equivalents of the other IASB Standards become operative) is appropriate and workable;***

We believe that we should be able to adopt the draft IFRS immediately it is issued as it has minimal impact on existing AASB standards. Therefore the AASB should amend all other necessary standards now to take into account this future requirement.

***(b) whether the consequential dual application of the Australian standard and AASB 1028 Employee Benefits for the interim year is too onerous or whether the relevant parts of AASB 1028 should be amended? If amendment is favoured, should AASB 1028 be re-issued or would it be sufficient to incorporate an interim 'override' in the new standard on share-based payment;***

We believe that dual application of the draft IFRS and the existing AASB 1028 is not too onerous. Where conflicts exist, we would prefer an interim 'override' to allow entities to adopt the provisions of the draft IFRS.

***(c) whether the date of measuring the fair value of equity instruments proposed in ED 2, grant date, should be used as the measurement date for disclosures of equity compensation proposed in ED 106 Director, Executive and Related Party Disclosures, instead of vesting date (as proposed in ED 106);***

Yes we believe that grant date is appropriate to use for ED 106 as we need to have consistency between the draft IFRS and ED 106 as it appears that the IASB will not change the measurement date to vesting. However as mentioned above, we believe that "offer date" is more appropriate in some circumstances as different employees may agree to the terms of their equity schemes on different dates (ie days or weeks apart) and we would not want to have to obtain numerous valuations doe what is essentially instruments granted under the same scheme.

***(d) whether the method of determining the expense related to unvested equity-settled share-based payment transactions to be recognised in an accounting period (based on units of service received times the expected value for units of service expected to be provided during the vesting period) is an appropriate method for determining the amount of equity compensation (as an element of remuneration) of an individual to be disclosed as proposed in ED 106 (in ED 106 Part 1, it is proposed that disclosure in respect of each director and specified executive of a disclosing entity be based on vesting date);***

Consistency is required between the expense measured under the draft IFRS and the amounts of remuneration disclosed under ED106. ED1O6 will need to change its terminology to reference to the measurement rules contained in this draft IFRS, which will mean changing to grant date.

This also highlights the need for the draft JERS to be amended to recognise the full expense of the options granted up front on the date of grant, as this matches the annual remuneration cycle of the employees concerned. Amortising over the effective service life, distorts the disclosure of the remuneration received by the employee.

***(e) whether the proposals are in the best interests of the Australian economy;***

We believe that these proposals are in the best interest of the Australian economy as it facilitates more transparent disclosure of the resources consumed by entities and conferred onto other parties. Telstra supports the process of international harmonisation, however we stress the importance of improving disclosures that will ensure the information is useful and understandable to users of the financial statements.

***(f) any issues relating to not-for-profit entities, including public sector entities, that may affect the implementation of the proposals; and***

There are no issues that we can identify and would find it unusual for not-for-profit entities and public sector entities issuing equity instruments in the ordinary course of operations.

***(g) any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals.***

There are no regulatory or other issues that we can identify that may affect the implementation of the proposals in this draft IFRS. Furthermore, it there are any issues that are discovered that may effect the implementation then the appropriate authorities should resolve those issues.

The draft IFRS should give consideration to the impact of a future standard on comparative information. In addition, the AASB has not indicated how the impact of initial application will be reported.