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January 31, 2003

Ms. Kimberley Crook
Project Manager
International Accounting Standards Board
30 Cannon Street, London EC4M 6XH
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Dear Ms. Crook

Intel Corporation is pleased to have the opportunity to comment on the Exposure Draft *ED 2- Share-based Payment (the "Exposure Draft")*.

Intel is the world's largest manufacturer of microprocessors and a leading manufacturer of networking and communication products. We attribute much of our success to the alignment of employee and shareholder interests created by our employee stock option program. The investment our shareholders have made in our employees via the stock option program (a long-term average of 2% potential dilution of shareholder interests) has been returned to them in the form of a company that has grown its share price by approximately 850 times from its IPO in 1971. We believe that the true economic cost of our stock option program (that is, dilution of shareholder ownership interests) is transparently reflected in our current financial reports via the earnings per share disclosure. The Exposure Draft would require Intel to impute the fair value of that shareholder cost into our financial statements as an expense in our income statement.

We note that the Exposure Draft's objective is to "ensure that an entity recognizes all share-based payment transactions in its financial statements, measured at fair value, so as to provide high quality, transparent and comparable information to users of financial statements". As a significant beneficiary of the strong capital markets in the U.S., we recognize the critical role that high quality and transparent financial reports play in an effective and efficient capital market system and it is from that perspective that we express our concern about the Exposure Draft's requirement to recognize an expense related to employee stock options (measured at fair value). For the reasons articulated below, we do not believe that requirement would accomplish your stated objective of improving the quality, transparency, and comparability of financial reporting.

We also recognize that the IASB may already be aware of some of the views expressed in this comment letter and note that the IASB has stated it's rational for rejecting those views in the Exposure Draft. We believe that it is worth repeating those views in this comment letter as they continue to be relevant to the overall meaningfulness and usefulness of financial reports and we hope that they will be read in that context. Where relevant, our comments also address the Exposure Draft's stated rational for dismissing certain views.

Our comments are divided into General Comments on the Exposure Draft's proposed recognition and measurement requirements and specific responses to the Questions asked in the Invitation to Comment section of the Exposure Draft (included as Appendix A). Our General Comments are organized into three areas that address the Exposure Draft's stated objectives: Financial Statement Transparency, Financial Statement Comparability, and Financial Statement Quality which we have broken down into Relevance and Reliability.

GENERAL COMMENTS

Financial Statement Transparency

The Exposure Draft argues that our financial statements would be more transparent if the fair value of employee stock option grants were included in our income statement. We disagree. In fact, we believe that expensing options would result in a more distorted picture of our actual performance and economic condition.

A transparent reporting of a particular transaction is one that gives a faithful representation of the underlying economic effect of the transaction on the reporting entity. We are not aware of any valid evidence that the grant of an employee stock option constitutes a economic cost to the granting entity (in fact, the empirical literature that we are aware of shows that the issuance of employee stock options normally either has no measurable cost to a granting entity, or actually benefits the entity and its shareholders). When we grant an employee stock option, we do not (and will not) experience an outflow of assets or a decline in asset value as a result of the stock option grant. Imputing an expense into our income statement (as the Exposure Draft would require) would imply that there is an economic cost (i.e. - an incremental cash outflow required) when no such cost (i.e. - no outflow) has or will occur. (In reality, stock option grants generate *incremental* asset inflows (through shareholders' equity) that arise from the proceeds and tax benefit received when they are exercised.) The incremental (non-cash) expense could cause the users our financial statements to reach incorrect conclusions about our operating performance and our prospects for generating future cash flows. That result would not improve the transparency of our financial statements.

The Exposure Draft argues that stock options are part of an employees total pay package and that a reporting entity benefits from the employee services rendered in exchange for the entire pay package. To not reflect the value of the stock option portion of the pay package in the income statement would understate the value of the employee services received. We agree that we benefit from the incremental motivation, commitment and productivity that stock options engender in our employees, but that is not the end of the analysis. The next question is whether those benefits should be recognized in the financial statements at something other than the cash (or other corporate assets) paid (or used up) in exchange for the services rendered. A good test case for this analysis is the scenario where a CEO is paid a nominal cash salary by a corporation. Clearly, the CEO's services are worth more than $0, but under current accounting, the true value of the CEO's service is not imputed into the reporting entity's income statement. Should the income statement be adjusted to recognize the "fair value" of the CEO's service? The rational underlying the Exposure Draft's conclusions suggest that it should. We disagree. Doing so would not be representative of the reporting entity's operating costs. It would not be transparent.

We also note that the IASB defines a corporate expense as "decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrence of liabilities that result in decreases in equity, other than those relating to distributions to equity participants," and we don't see any of those things happen upon the grant of an employee stock option. Therefore, we conclude that the Exposure Draft's proposed requirement to recognize the fair value of employee stock option grants as an expense in the income statement to be inconsistent with the IASB's conceptual framework. The Exposure Draft acknowledges that observation and goes on to dismiss it on the grounds that the reporting entity actually does incur an expense because services received are "instantaneous assets" that are consumed upon receipt. This notion of an "instantaneous asset" appears to us to be in conflict with the IASB's existing conceptual framework and it strikes us that this line of argument may have been constructed in order to justify the IASB's predetermined conclusion that stock option grants ought to give rise to a corporate expense. If that is in fact the case, we encourage the IASB to first clarify their underlying conceptual principles so that they accommodate such a conclusion.

We believe that the current earnings per share disclosure (augmented by additional disclosures about the stock option program – see the Relevance section below for further discussion) transparently reflects the economic effect of our stock option grants. Our shareholders are willing to invest a portion of their ownership interest in our employees and expect to be compensated by the incremental value created by an employee base that is motivated by that ownership stake on the principle that a smaller piece of a larger pie is better than a larger piece of a smaller pie. The EPS disclosure transparently conveys the dilutive impact of that ownership transfer. The EPS disclosure combined with certain of the footnote disclosures proposed in the Exposure Draft and certain additional disclosures (discussed below in the Relevance section) would give investors and other users of our financial statements a clear understanding of the nature and extent of our employee stock option program and the ability to assess the potential cost of the program to current and future shareholders.

Financial Statement Comparability

Some argue that the current accounting for employee stock option grants impairs the comparability of financial statements. An often cited hypothetical example includes two very similar companies (Company A and Company B). The companies are virtually the same except that Company A pays its employees exclusively in cash and Company B pays its employees exclusively in stock options. Company B will appear to be a much more attractive investment even though the two companies, with the exception of the method in which they compensate their employees, are virtually the same. Those that cite this example believe that it illustrates the need to recognize the cost of employee stock options in Company B's income statement to ensure financial statement comparability. We disagree. The income statements of Company A and Company B should not appear the same because Company B will generate much more cash from its operations than Company A. That difference should be transparent in the financial statements, but imputing the hypothetical value of employee stock options into Company B's income statement will make the cash operating costs of the two companies appear similar and cause users of their financial statements to draw incorrect conclusions.

The fact that an investment in Company B will likely be diluted over time as a result of stock option grants to the employees should be transparent to the potential investors. However, the most transparent way to convey that information is not by making Company B's income statement look exactly like Company A's income statement, it is by reflecting the dilution caused by Company B's stock option grants in the earnings per share disclosure.

Also, as more fully discussed in the Reliability section below, the requirement to use an option pricing model to measure the value of an employee stock option will result in highly subjective and potentially unreliable data being recognized in the income statement. The subjectivity of assumptions used in option pricing models will yield diversity in application from one company to the next, thereby, impairing comparability and confusing the users of financial statements.

Our 1997 employee stock option grants illustrate the unreliable fair value measures that result from the use of subjective volatility input variables. In 1997 we used an expected volatility of 36 percent (based on actual historical experience) to estimate the value of our 1997 employee stock option grants for purposes of complying with the FAS 123 disclosure requirement. The actual volatility during the expected life of our 1997 option grants turned out to be 49 percent; 36 percent higher than the expected volatility we used to measure the value of those options. That translates into a $103 million difference. While one could attempt to mitigate this outcome in the future by adjusting historical volatility based on some expectation of future experience, there is no guarantee that such an adjustment would improve the precision of the fair value estimate. However, the subjective nature of the adjustment would surely guarantee a further divergence in comparability from one company to the next.

Financial Statement Quality

Relevance

We believe that the Exposure Draft's requirement to expense the fair value of an employee stock option would impair the relevance of our financial statements.

Discussions with our investors and other users of our financial statements indicate that they care most about our ability to generate future net cash inflows and that their primary interest in our financial statements is that they accurately depict our ability to do so. We therefore assume that our investors would find financial statement information that has no bearing on our ability to generate future cash flow irrelevant and we would further assume that they would remove such information (assuming it can be easily identified) when analyzing our financial statements. In fact, a recent survey of the "sell side" analysts that cover our stock confirmed that assumption. The survey found that those analysts would not find the inclusion of a stock option related expense in our income statement to be useful information and several analysts indicated that it could impair their ability to accurately assess our performance.

The Exposure Draft's requirement to expense the fair value of employee stock option grants would introduce a charge into our income statement that is not reflective of any past, present, or future cash outflow. The fact that financial statements are prepared for the benefit of investors and other users of financial statements combined with our understanding of the kind of information they find useful causes us to conclude that the Exposure Draft's requirement would impair the overall relevance of financial statements.

As anecdotal evidence, we would add that in the six years since we implemented the fair value disclosure requirements of FAS 123, we have received few questions from investors or analysts about the pro-forma disclosure. The questions we have received resulted from the recent wave of corporate financial reporting scandals (which, in our view, has nothing to do with the accounting for stock options). Given the number of analysts that follow Intel and the relative significance of our stock option program, we would conclude from this that the users of our financial statements do not find the information to be relevant.

What investors and other users of our financial statements do find relevant is additional information to help them assess the impact our stock option program will have on "their piece of the pie" in future periods. We have found that our investors find quarterly disclosures about the philosophy of our program, expected grant levels, actual grants as a percentage of outstanding shares and in-the-money vs. out-of-the money option information, etc. to be useful. To that end, we began disclosing such information on a quarterly basis in the second quarter of 2002. We would encourage the IASB to consider similar disclosure requirements when they redeliberate the Exposure Draft.

Reliability

The Exposure Draft would require the use of an option-pricing model to measure the fair value of an employee stock option. We believe that approach would result in highly questionable and unreliable financial results.

It is widely acknowledged that existing option valuation techniques (e.g. – Black-Scholes) were developed to value short-lived, freely traded options and never were intended to value longer term, non-transferable employee stock options that are subject to vesting requirements. It is our understanding that option traders put less reliance on option pricing models as the time to expiration increases beyond just six months because of the difficulty in estimating volatility over that longer time frame. To compensate for the inability to reliably estimate volatility beyond six months, option traders will subjectively adjust an option pricing model's results for such things as market liquidity, changes in supply and demand and the level of risk they are willing to take. This problem is further compounded when you move to a 5+ year non-transferable employee stock option and one wonders how the value of such options could be measured with any degree of certainty. Yet, the Exposure Draft would require the use of an option-pricing model to measure the fair value of employee stock options.

The Exposure Draft acknowledges the differences between traded options and employee options and proposes (similar to FAS 123) to compensate for those differences by requiring that the expected life of the option, rather than its contractual term, be used as an input into the option-pricing model. While it is clear that the use of expected life rather than contractual life can significantly reduce the fair value estimate of an option, it is a subjective modification of an input variable that only coincidentally could provide a reliable estimate of the effect of the restrictions inherent in employee stock options on their fair value and it does nothing to improve the reliability of the fair value estimate.

For example, we used an expected life of 6.5 years to estimate the fair value of our 2000 employee stock option grants. Because of the significant drop in our share price since 2000 (the average exercise price for 2000 grants is $54.68 vs. a current market price of approximately $16.50), the actual life of our 2000 stock option grants will most likely be something very close to the contractual life (if they get exercised at all). The impact of using the 6.5 year expected life versus the 10 year contractual life was an approximate $1 billion reduction in the measured value of our 2000 grants. This example not only illustrates how dramatically wrong an option pricing model with subjective assumptions can be, but it also illustrates the counterintuitive impact the use of expected life has on the fair value estimate. If we would have had perfect information regarding the expected life of our 2000 grants, we would have ascribed an additional $1 billion to option grants that most likely will expire worthless.

We realize that estimation is inherent in financial reporting, and that accounting estimates, by their very nature, are imprecise. Lower of cost or market reserve on inventory, allowances for bad debt & pension obligations are examples of the need for subjective estimates in current accounting practice. Ultimately, however, the estimation will be trued up based on an independent cash transaction. On the other hand, the estimated fair value that would be assigned to an employee stock option will never be verified subsequently through an independent transaction. This potential for wide ranges of estimated values with no subsequent true up calls into question the usefulness of the information that would be reported under the Exposure Draft's requirements.

If the IASB retains the Exposure Draft's conclusion that employee stock options should be expensed in the income statement, we believe that cost should be measured based only on the financing cost associated with the option (often times referred to as the minimum value method). The Exposure Draft correctly identifies the two components of an options fair value: intrinsic value and time value. The time value component can be further broken down into the volatility component and the financing component. For a typical "at the money" employee stock option, there is no intrinsic value at the measurement date (i.e. – date of grant) and there is no ability to realize the volatility component of the time value. The only way the volatility component can be realized is by selling the option, but the employee is not permitted to do so. Therefore, the only relevant measure of an employee stock options value is the financing component of the time value

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Thank you for the opportunity to comment on this Exposure Draft. We urge the IASB to consider these comments as it redeliberates share-based payment issues and proceeds to the issuance of a final standard. Please do not hesitate to contact either me (408 765 1444), or John Hertz, Accounting Policy Controller (503 696 7476), with any questions on our comments.

Sincerely,

/s/ Andy D. Bryant

Andy D. Bryant
Executive Vice President
Chief Financial and
Enterprise Services Officer

Appendix A

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?

Since the IASB is starting with a "clean sheet of paper" we would agree an approach that addresses equity-based compensation on a comprehensive and consistent basis. For reasons previously stated, we believe that comprehensive conclusion should be that any stock transaction that does not give rise to assets or result in the outflow of corporate assets does not result in an expense of the corporation.

While our previous comments and those in reply to the remainder of your questions focus primarily on employee stock options, they similarly apply to all equity grants that do not result in an out-flow of corporate assets.

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?

No, we do not believe that these recognition requirements are appropriate. As noted previously in this response, we do not believe that an equity grant that does not result in an outflow of corporate assets should be recognized as an expense in an entity's income statement. Further, we do not believe that it is possible to reliably measure what that expense would be.

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?

If one were to attempt to measure the fair value of an employee's service, we would not agree that the fair value of the option is an appropriate measure. If a company were to reward an employee with cash rather than an unvested non-transferable option, the employee would take less cash than the value of the option. Therefore, the value of the option is likely to exceed the amount that would be paid in cash and, accordingly, reflecting the fair value of that option in the income statement will overstate the cost of the employee service.

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?

A good or service should be measured upon receipt typically by reference to the corporate asset transferred in the exchange.

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 see no need to measure the equity instrument since the transaction should not be recognized in the financial statements (other than by including the potentially dilutive option in the earnings per share calculation).

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 a good or a service received from a third party would usually be more readily determinable than the fair value the equity instrument granted in the exchange transaction.

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 do not believe that the fair value of either employee service or a non-transferable equity instrument is readily determinable. Further and as previously stated, we do not believe that an expense in an entity's income statement relating to employee services that do not result in the outflow of a corporate asset would be meaningful information to the users of the financial statements. In fact, we believe it would be misleading. Additionally, we find it inconsistent that the Exposure Draft goes to great lengths to make it clear that the focus is on recognizing and valuing the services received (not the equity instrument) and then prohibits the direct measure of the service while requiring that the equity instrument be measured.

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?

Option grants are typically awarded 1) in consideration of past performance, 2) to incent future performance and 3) as a retention mechanism. However, we see no reliable way to allocate an options value among those components. Presuming that the "consideration" is entirely related to future service would simplify the accounting, but it also overstates the cost allocated to the future periods.

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 believe that this approach would unnecessarily complicate the attribution of the employee service. If the IASB were to require the expensing of employee stock options, we would simply amortize the measured cost over the vesting period.

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?

This proposed requirement is consistent with the Exposure Draft's underlying premise that services received should be reflected in the entity's income statement regardless of the consideration (or whether there is any at all). Because we do not believe that services received that do not result in a corporate asset outflow are a corporate expense, we do not agree with this requirement.

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 do not aware of an approach that would reliably measure the value of a stock option. Further, the use of option pricing models will ensure that inaccurate and unreliable estimates of the stock options value will erode the quality of the financial statements...Also, as described previously in this response, the only element of pricing model that could be considered relevant to an employee stock option is the financing component.

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?

No, we do not agree that simply replacing an option's contracted life with its expected life is an appropriate means of adjusting the option's fair value for the effects of non-transferability. As described previously in this response, we believe that approach would only coincidentally provide a representative measure of the liquidity discount would do nothing to improve the reliability of the fair value estimate. Further, we are not aware of an alternative approach that would reliably measure the liquidity discount

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?

Vesting provisions absolutely should be considered if one were to attempt to measure the fair value of an employee stock option. However, we don't believe that there is a reliable way to alter option-pricing models for the vesting terms of employee stock options.

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?

In FAS 123, the FASB concluded that no reasonable method existed to estimate the value added by a reload feature. We are not aware of any improvements in the ability to measure a reload feature since that time and therefore we do not support the proposed requirement to measure the reload feature at grant date.

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?

The most significant common feature of employee stock options is that the employee does not have the ability to monetize the volatility component of the stock options value. It is for this reason that employees would surely take less in cash than the measured value of a stock option. Therefore, the measure of an employee stock option should ignore volatility and consider only its intrinsic value and its financing cost.

Question 16

The draft IFRS does not contain prescriptive guidance on the estimation of the fair value of options, consistent 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?

If the IASB retains the Exposure Draft's conclusion that the fair value of non-transferable employee stock options should be expensed in the income statement, the subjectivity of the option-pricing model inputs will create significant comparability issues and impair the usefulness of financial statements. We would therefore encourage the IASB to mitigate that effect by providing specific guidance on the approach for estimating volatility and the estimated life of the option.

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

If the IASB retains the Exposure Draft's conclusion that employee stock options should be expensed in the income statement, we would agree with this requirement.

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.

The requirement to continue recognizing expense during the vesting period, even when the option is cancelled or forfeited, is consistent with the Exposure Draft's underlying premise that services received should be reflected in the entity's income statement regardless of the consideration (or whether there is any at all). However, we do not believe that services received that do not result in a corporate asset outflow are a corporate expense. We therefore do not support this requirement.

On the other hand, we would support the recognition of an expense in the entity's income statement if an entity were to make a cash payment (or any other sacrifice that results in an outflow of corporate assets).

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 this approach, this transaction will result in the outflow of corporate assets.

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.

If the settlement decision is in the control of the supplier of goods or services, we agree. If the settlement decision is in the control of the entity, we would not recognize expense unless the entity ultimately settles with a company asset. Although, we would measure the liability at intrinsic value as that will be the ultimate measure and would be easier to apply.

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 with item (a). As described previously in this response, we do not believe either item (b) or item (c) is relevant. We do believe that incremental disclosures of significant aspects of an employee stock option program would be useful to investors and other users of financial statements. In that regard, we would recommend disclosure of the following information:

- Description of option programs including dilution goal and approval process
- Distribution and dilutive effect of options
- General option information such as grant amounts, exercise price, in-the-money and out-of-money information
- Executive options such as grant amount and as a percentage of total employee grant

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 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.

If the Exposure Draft were adopted, we would agree with these transition requirements.

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 that this requirement will result in the recognition of gains or losses in an entity's income statement relating to changes in the market value of the entity's outstanding equity instruments. This is inconsistent with the IASB's underlying conceptual framework.

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 recognized 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 BC70- 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.)

As previously stated, we do not agree with either FAS123's or the Exposure Draft's fundamental conclusion that employee stock options should be expensed at fair value. As to the specific differences noted in this question, we agree with the Exposure Draft's treatment for the following items:

- Employee stock purchase plans should be included in the scope of any new accounting standard on equity based transactions
- Forfeitures should be considered if one is going to try and value an employee stock option
- That grant date is the appropriate measurement date regardless of whether the grant is to an employee or a non employee
- The fair value measurement of stock appreciation rights

We agree with FAS 123's treatment for the following items:

- The reversal of previously recognize expense relating to forfeited employee stock options
- The treatment of realized tax benefits

We do not agree with either the Exposure Draft of FAS 123's requirement to recognize an expense in the income statement relating to employee stock options; whether under a fair value measurement as proposed and preferred by both the Exposure Draft and FAS 123 or under a intrinsic value measurement as required by FAS 123.

Question 25

Do you have any other comments on the Exposure Draft?

Please refer to our comment summary in the attached letter.