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Dear Sirs

We are writing in response to the invitation to comment on ED 2 "Share-based payment".

We particularly welcome the examples included in the appendices, which we believe are a helpful addition.

We have not answered IASB Question 24 as all these issues are addressed in our responses to the other questions.

Should you have any queries, please do not hesitate to contact me.

Yours sincerely,

Michael Kavanagh B.Comm CPA
Chairman
Financial Reporting Sub-Committee

QUESTIONS

IASB Question 1

Paragraph 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?

Yes, we believe the scope is appropriate and are not aware of any reasons for exemptions from the standard.

IASB Question 2

Paragraphs 4-6 of the draft IFRS propose requirements for the recognition of share-based payment transactions, including the recognition of an expense when the goods or services received or acquired are consumed.

Are these recognition requirements appropriate? If not, why not, or in which circumstances are the recognition requirements inappropriate?

Yes we agree in principle that transactions using equity instruments should result in charges to the profit and loss account when goods or services received or acquired are consumed. Equally an entity should recognise a corresponding increase in equity if the goods or services were received in an equity-settled share-based payment transaction, or a liability if the goods or services were acquired in a cash-settled share-based payment transaction.

IASB Question 3

For an equity-settled share-based payment transaction, the draft IFRS proposes that, in principle, the entity should measure the goods or services received, and the corresponding increase in equity, either directly, at the fair value of the goods or services received, or indirectly, by reference to the fair value of the equity instruments granted, whichever fair value is more readily determinable (paragraph 7). There are no exemptions to the requirement to measure share-based payment transactions at fair value. For example, there are no exemptions for unlisted entities.

Is this measurement principle appropriate? If not, why not, or in which circumstances is not appropriate?

After much discussion, the committee has concluded that, despite the attractions of using a simpler measurement basis such as the "minimum value approach", the measurement of share-based payment transactions at fair value is appropriate. Using another approach could lead to confusion and potentially lack of comparability.

IASB Question 4

If the fair value of the goods or services received in an equity-settled share-based payment transaction is measured directly, the draft IFRS proposes that fair value should be measured at the date when the entity obtains the goods or receives the services (paragraph 8).

Do you agree that this is the appropriate date at which to measure the fair value of the goods or services received? If not, at which date should the fair value of the goods or services received be measured? Why?

Yes, we agree that it is appropriate to measure the fair value of the goods or services on the date the entity obtains these goods or services.

IASB Question 5

If the fair value of the goods or services received in an equity-settled share-based payment transaction is measured by reference to the fair value of the equity instruments granted, the draft IFRS proposes that the fair value of the equity instruments granted should be measured at grant date (paragraph 8).

Do you agree that this is the appropriate date at which to measure the fair value of the equity instruments granted? If not, at which date should the fair value of the equity instruments granted be measured? Why?

Yes, we agree it is the appropriate date at which to measure the fair value of the equity instruments granted as this is the date the transaction is agreed and the obligation is triggered. We believe the vesting date is inappropriate as this remeasures the consideration for the transaction and anticipates future events which is inconsistent with IASB's *Framework for the Preparation and Presentation of Financial Statements* and the ASB equivalent.

IASB Question 6

For equity-settled transactions with parties other than employees, the draft IFRS proposes a rebuttable presumption that the fair value of the goods or services received is more readily determinable than the fair value of the equity instruments granted (paragraph 9 & 10).

Do you agree that the fair value of the goods or services received is usually more readily determinable that the fair value of the equity instruments granted? In what circumstances is this not so?

Yes, we agree that the fair value of the goods or services received is usually more readily determinable as in most cases an established market price exists for such goods and services.

IASB Question 7

For equity-settled transactions with employees, the draft IFRS proposes that the entity should measure the fair value of the employee services received by reference to the fair value of the equity instruments granted, because the latter fair value is more readily determinable (paragraph 11 & 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?

Due to the volatility of share prices in recent times, we believe valuing the fair values of equities is extremely difficult. It is possible that the company could be paying for employee services at inflated prices in some circumstances. However, the committee feels that the IFRS proposals are the only practical solution to the issues and is in support of them.

IASB Question 8

Paragraph 13 and 14 of the draft IFRS proposes 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 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?

Yes, we agree that this is reasonable to presume.

IASB Question 9

If the services received are measured by using the fair value of the equity instruments granted as a surrogate measure, the draft IFRS proposes that the entity should determine the amount to attribute to each unit of service received, by dividing the fair value of the equity instruments granted by the number of units of service expected to be received during the vesting period (paragraph 15).

Do you agree that if the fair value of the equity instruments granted is used as a surrogate measure of the fair value of the services received, it is necessary to determine the amount to attribute to each unit of service received? If not, what alternative approach do you propose? If an entity is required to determine the amount attributable to each unit of service received, do you agree that this should be calculated by dividing the fair value of the equity instruments granted by the number of units of services expected to be received during the vesting period? If not, what alternative method do you propose?

The proposed method appears unnecessarily cumbersome and unwieldy.

Having studied other methodologies such as straight line or graded vested, we concluded that the "unit of service" method proposed, would not yield an estimate that is materially more accurate compared with the burden of calculation.

IASB Question 10

In an equity-settled share-based payment transaction, the draft IFRS proposes that having recognised the services received, and a corresponding increase in equity, the entity should make no subsequent adjustments 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, the requirement does not preclude the entity from recognising a transfer within equity, i.e. a transfer from one component of equity to another.

Do you agree with this proposed requirement? If not, in what circumstances should an adjustment be made to total equity and why?

We are uncomfortable with the proposed treatment. It does not seem to make sense that an entity, which recognised a charge for those services, does not subsequently reverse the transaction if the equity instrument granted does not vest. It would seem more appropriate that, what is in effect a write back of a previously recognised expense should be written back to the profit and loss account. At the very least, the entity should have to recognise a transfer within equity rather than just not being precluded from doing so.

IASB Question 11

The draft IFRS proposes that the entity should measure the fair value of equity instruments granted, based on market prices 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 lode 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 options pricing model?

We agree with the use of option pricing models to estimate the fair value of options granted. Although there is a possibility that different models may generate different estimates of fair value, the disclosures required by the FRED are sufficient to ensure that users of financial statements are fully aware of how the inputs to the model have been ascertained. This should ensure that such users of financial statements are aware of all factors and assumptions that have lead to the estimation of fair value.

IASB Question 12

If an option is non-transferable, the draft IFRS proposes that the expected life on an option rather than it's contracted life should be used in applying an option pricing model (paragraph 21). The draft IFRS also proposes requirements for options that are subject to vesting conditions and therefore cannot be exercised during the vesting period (paragraph 22).

Do you agree that replacing an option's contracted life with its expected life when applying an option pricing model is an appropriate means of adjusting the options fair value for the effects of non-transferability? If not, do you have an alternative suggestion? Is the proposed requirements for taking into account the inability to exercise an option during the vesting period appropriate?

Yes, we agree that replacing the contracted life with its expected life in this case is appropriate.

IASB Question 13

If a grant of shares or options is conditional upon satisfying specified vesting conditions, the draft IFRS proposes that these conditions should be taken into account when an entity measures the fair value of the shares or options granted. In the case of options, vesting conditions should be taken into account either by incorporating them into the application of an option pricing model or by making an appropriate adjustment to the value produced by such a model (paragraph 24).

Do you agree that vesting conditions should be taken into account when estimating the fair value of options or shares granted? If not, why not? Do you have any suggestions for how vesting conditions should be taken into account when estimating the fair value of shares or options granted?

Yes, we agree that the vesting conditions should be taken in to account when estimating the fair value of options or shares granted.

IASB Question 14

For options with a reload feature, the draft IFRS proposes that the reload feature should be taken into account, where practicable, when an entity measures the fair value of the options granted. However, if the reload feature is not taken into account in the measurement of the fair value of the option granted, then the reload option granted should be accounted for a new option grant (paragraph 25).

If this proposed requirement appropriate? If not, why not? Do you have an alternative proposal for dealing with options with reload features?

Yes, we agree that this proposed requirement is appropriate.

IASB Question 15

The draft IFRS proposes requirements for taking into account various features common to employee share options, such as non-transferability, inability to exercise the option during the vesting period, and vesting conditions (paragraphs 21-25).

Are there other common features of employee share options for which the IFRS should specify requirements?

No, we are not aware of any other common features of employee share options for which the IFRS should specify requirements.

IASB Question 16

The draft IFRS does not contain prescriptive guidance on the estimation of the fair value of options, consistently with the Board's objective of setting principles-based standards and to allow for future developments in valuation methodologies.

Do you agree with this approach? Are there specific aspects of valuing options for which such guidance should be given?

We agree that the IFRS should not contain prescriptive guidance on the estimation of the fair value of options for the following reasons-

(i) **If the IFRS did contain prescriptive guidance (for example if it promulgated that the Black Scholes model was to be used exclusively), it might lead to a situation whereby companies might apply the methodology recommended by the IASB without careful consideration of whether such application was appropriate (given the relevant circumstances at that time).**

(ii) **By not offering prescriptive guidance the IFRS allows for future developments in valuation methodologies to be used to estimate fair value. Such developments in valuation methodologies may prove to be more accurate that current approaches, and so it is prudent that the IFRS not exclude any such techniques from being used in the future.**

IASB 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 to recognise additional amounts for services received during the remainder of the vesting period, i.e. additional to the amounts recognised in respect of the original option grant. Example 3 in Appendix B 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?

Yes, the committee agrees that if an entity reprices a share option, or otherwise modifies the terms or conditions on which equity instruments were granted, it should measure the incremental value granted upon repricing and include that incremental value when measuring the services received during the remainder of the vesting period.

We believe that the first approach illustrated in Example 3 is the most appropriate because it reflects better the treatment of the repriced option and the recognition of the incremental value of the new option separately from the original option.

IASB Question 18

If an entity cancels a share option grant during the vesting period (other than a grant cancelled by forfeiture when the vesting conditions are not satisfied), the draft IFRS proposes that the entity should continue to recognise the services rendered by the counterparty in the remainder of the vesting period, as if that grant had not been cancelled. The draft IFRS also proposes requirements for dealing with any payment made on cancellation and/or a grant of replacement options, and for the repurchase of vested equity instruments.

Are the proposed requirements appropriate? If not, please explain why not and provide details of your suggested alternative approach.

We are uncomfortable with the proposed requirements. We believe that this method is contrary to the IAS Framework document and the ASB Statement of Principles. The entity should not continue to recognise an expense if options are cancelled. The committee noted the IFRS proposed approach to repricing and other modifications to the terms and conditions of share based payments and the argument for consistent treatment. However, the committee felt it is possible that a share or option grant is cancelled without a compensation payment and therefore the argument for consistent treatment is lessened.

We also believe the compensation paid on the cancellation of unvested equity should be accounted for as an expense, and not as a debit to equity, since it represents an expense to the entity due to the cancellation of the equity.

IASB Question 19

For cash-settled share-based payment transactions, the draft IFRS proposes that the entity should measure the goods or services acquired and the liability incurred at the fair value of the liability. Until the liability is settled, the entity should remeasure the fair value of the liability at each reporting date, with any changes in value recognised in the income statements.

Are the proposed requirements appropriate? If not, please provide details of your suggested alternative approach.

Yes, the proposed requirements are appropriate.

IASB Question 20

For share-based payment transactions in which either the entity or the supplier of goods or services may choose whether the entity settles the transactions 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 of the entity has incurred a liability to settle in cash, or as an equity-settled share-based payment transaction of 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.

Yes. In our view the proposed requirements are appropriate.

IASB Question 21

The draft IFRS proposes that an entity should disclose information to enable users of financial statements to understand:

(a) the nature and extent of share-based payment arrangements that existed during the period,

(b) how the fair value of the goods or services received, or the fair value of the equity instruments granted, during the period was determined, and

(c) the effect of expenses arising from share-based payment transactions on the entity's profit or loss.

Are these disclosure requirements appropriate? If not, which disclosure requirements do you suggest should be added, deleted or amended (and how)?

We are concerned that the disclosures could become too lengthy and complex for shareholders and other users of financial statements. However, we support the IASB's suggestion to provide additional disclosure surrounding key assumptions (volatility and vesting conditions) for the reasons outlined in our answer to Question 11. We would also add that the names of directors to whom share options were issued should be disclosed.

IASB Question 22

The draft IFRS proposes that an entity should apply the requirements of the IFRS to grants of equity instruments that were granted after the publication date of this Exposure Draft and had not vested at the effective date of the IFRS. It also proposes that an entity should apply retrospectively the requirements of the IFRS to liabilities existing at the effective date of the IFRS, except that the entity is not required to measure vested share appreciation rights (and similar liabilities) at fair value, but instead should measure such liabilities at their settlement amount (i.e. the amount that would have been paid in settlement of the liability had the counterparty demanded settlement at the date the liability is measured).

Are the proposed requirements appropriate? If not, please provide details of your suggestions for the IFRS's transitional provisions.

We are in agreement with the requirement

IASB Question 23

The draft IFRS proposes a consequential amendment to IAS 12 (revised 2000) *Income Taxes* to add an example to that standard illustration 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 are in agreement with the requirement

IASB Question 24

In developing the Exposure Draft, the Board considered how various issues are dealt with under the US standard SFAS 123 *Accounting for Stock-Based Compensation*, as explained further in the Basis for Conclusions. Although the draft IFRS is similar to SFAS 123 in many respects, there are some differences. The main differences include the following:

(a) Apart from transactions within the scope of another IFRS, the draft IFRS does not propose any exemptions, either from the requirement to apply the IFRS or from the requirement to measure share-based payment transactions at fair value. SFAS 123 contains the following exemptions, none of which are included in the draft IFRS:

- Employee share purchase plans are excluded from SFAS 123, providing 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 for Stock Issued to Employees (paragraph BC70-BC74 in the Basis for Conclusions give an explanation of intrinsic value); and

- Unlisted (non-public) entitles 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 (paragraph 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 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 performance commitment is reached or (ii) the date performance s 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 (refer to paragraph BC70-BC81 of the Basis for Conclusions for a discussion on 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.* (* In the IASB's Invitation to Comment, it points out that "further details of the differences between the draft IFRS and SFAS 123 are given in the FASB's Invitation to Comment".)