



**Submission**

**to**

**INTERNATIONAL ACCOUNTING STANDARDS BOARD**

**on**

**EXPOSURE DRAFT 2 SHARE-BASED PAYMENT**

**6 March 2003**

## Australian Institute of Company Directors

Australian Institute of Company Directors (AICD) is the peak organisation representing the interests of company directors in Australia. Current membership is over 17,000, drawn from large and small organisations, across all industries, and from private, public and the not-for-profit sectors. Membership is on an individual, as opposed to a corporate basis.

AICD is a federation of seven State divisions, each of which is represented on a National Council. Overall governance of the AICD is in the hands of its Board of Directors which is comprised of the seven division Presidents, plus a Chair, Vice Chairs and a Treasurer. AICD has several national policy committees, focusing on issues such as law, accounting and finance, sustainability, taxation and economics, and national education, along with task forces to handle matters such as corporate governance.

The key functions of AICD are:

- to promote excellence in director's performance through education and professional development
- to initiate research and formulate policies that facilitate improved director performance
- to represent the views and interests of directors to Government, regulatory bodies and the community
- to provide timely, relevant and targeted information and support services to members and, where appropriate, Government and the community
- to maintain a member's code of professional and ethical conduct
- to uphold the free enterprise system
- to develop strategic alliances with relevant organisations domestically and internationally to further the objectives of the AICD.



## Introduction

AICD welcomes the opportunity to make a submission to the International Accounting Standards Board on Exposure Draft 2 Share-Based Payment (ED 2).

## Commentary

Reform in the reporting and disclosure of shares and share options issued to directors and executives as part of remuneration for services rendered is appropriate and necessary. Accordingly we support the IASB's intention to develop an international standard relating to share based payments.

In our September 2002 submission to the Australian Accounting Standards Board (AASB) on its Exposure Draft 106 "Director, Executive and Related Party Disclosures"(ED 106) we agreed with the AASB's proposal to value and disclose equity compensation benefits at their vesting dates as opposed to the grant date. After revisiting this issue and after some considerable debate, we have now concluded that the **grant** date is the more appropriate date to value and expense options. We believe the grant date more accurately reflects the true value of the benefit provided to the employee and the cost to the company in providing that benefit. This view is conditional upon the standard prescribing an objective valuation methodology to value share options. Our members are most concerned that in the absence of a reliable measurement methodology inconsistent and unacceptable practices will emerge resulting in inconsistent financial reporting by entities. Accordingly the AICD urges the IASB to provide sufficient and appropriate guidance so as to ensure consistency in financial reporting. We recommend that the draft International Financial Reporting Standard mandate a valuation methodology or formula, which is simple to implement and provides an objective valuation of share options.

To ensure transparency in financial reporting AICD supports a disclosure regime to enable users of the financial statements to understand the nature and extent of share-based payment arrangements and the movements in fair values of these benefits subsequent to their grant date.

Due to the complexity involved with the method, AICD does not support the American Opinion 25 intrinsic value accounting model whereby options are remeasured at each balance date and included in the financial result.

In our submission to the AASB in October 2000 on the G4+1 proposals for Accounting for Share Based Payments, the AICD opposed the recognition of employee option schemes. This reflected AICD's concern at the time that it is very difficult to value share options accurately, and on a comparable basis, particularly options with substantial performance hurdles. Whilst we continue to be concerned that the subjectivity of certain assumptions has a dramatic impact on option valuations, we acknowledge that since that time there has been considerable movement in this debate globally. These developments change AICD's view only if an agreed and acceptable method for valuation of options can be determined and

applied consistently and comparably between companies domestically and internationally. We consider that further guidance is required from the IASB, preferably within the standard, to ensure the reliability and comparability of estimated values for employee option schemes.

There are two additional issues particular to Australia which whilst not of immediate concern to the IASB may provide useful additional background. These issues are elaborated in further detail in Annexure 1 to this Submission.

## **Annexure 1**

### **Specific Australian Concerns**

#### **Australian Disclosure Requirements**

A particular problem arises in Australia because Australian GAAP currently requires disclosures under AASB 1028 and AASB 1017. These disclosure requirements were implemented to fill a perceived void in disclosure relating to share-based payments in Australia. AASB 1028 was modified to establish a disclosure requirement for r share-based payments in the absence of a requirement to expense options. In ED 106 the AASB proposes increasing the transparency of disclosure of executive remuneration issues in an attempt to increase corporate governance oversight over remuneration. ED 2 (Australian ED 108) would require the measurement and recognition as an expense of share-based payments.

As a result of AASB 1028 and AASB 1017 having developed separately Australia has a set of standards that potentially overlap and duplicate disclosures and which could be inconsistent in their valuation methods and the timing at which expensing is required. In the interim period and until international standards are adopted, Australian disclosures will be made under two different financial reporting frameworks - Australian and international. Two otherwise identical transactions will have a different impact on financial performance as one is granted to an employee and one is granted to a non-employee. Employee transactions will be recorded in the initial year of adoption, but non-employee transactions will not. In addition, a single transaction will have one impact on the financial statements, and another impact on director remuneration disclosures, because the recipient has a different status. For instance, a grant to a director or a top executive will be valued at grant date for the purposes of recognition in profit (ED 2/AASB ED 108), but will be disclosed based on vesting date valuation for the purposes of director or executive remuneration disclosures (AASB 1017/1028).

Most significantly, the phased introduction of the standards will result in many changes to the amounts and details that are reported or disclosed in the financial statements of Australian companies over the next 2-3 years. For example,

1. Financial year 2003/4 will maintain the status quo, with the introduction of the AASB 1028 disclosures in 2003
2. Financial year 2004/5 will see the expensing of employee share-based payments, but not for non-employees, and the restatement of the prior year result for employee transactions. Non-employee transactions will need to be disclosed under the requirements of AASB 1028, but employees under ED 2/AASB ED 108
3. Financial year 2005/6 will see the expensing of non-employee share-based payments, and the restatement of the 2004/5 result, and full disclosure under ED 2/AASB ED 108(It is not certain at this time when ED 106 will be implemented).

Clearly this will not result in the desired increase in transparency. It is important that Australian recognition and disclosure requirements are brought in line, so that consistency is achieved, and the disclosures are fully considered so as to achieve maximum that transparency.

## **Australian Tax Issues**

There are two important Australian domestic tax issues that are not necessarily within the realm of the IASB but which we believe still need to be considered. Firstly, we consider that the Australian tax laws need to be amended to deal with share-based payments. Currently in Australia when options are issued the option premium is recognised in equity as an option premium reserve. A tax issue arises when the option is exercised and the option premium is transferred to the share capital account. This is because the transfer “taints” the account and franking balances are no longer available. Although it is possible to elect to rectify the share capital account this comes at a cost. Currently Australian companies are not transferring balances contained in the option premium reserve to share capital, in order to avoid this tainting issue. However, the result of not transferring the balances is that the option premium reserve account balance bears no relationship to the options currently on issue by the company.

The second important domestic tax issue for Australian companies is that (except in the rare cases where a deduction up to a maximum of A\$1,000 is available) options expensed are not currently tax deductible. The Australian government has indicated that Australian tax law will not be amended to give further tax deductions for options expensed. This will mean that the accounting and taxation treatment of options will be inconsistent in Australia which puts Australian companies at a competitive disadvantage.