CL 141

AstraZeneca PLC
F174
Alderley House
Alderley Park
Macclesfield
SK10 4TF

7th March 2003

Dear Sirs

ED 2 "Share-based payment"

We support the IASB in its aim of producing a set of technically sound standards and are pleased to attach our responses to the exposure draft on share based payment.

We support in principle the introduction of requirements to expense share-based payments, particularly in the area of share options granted to employees. However, we would emphasise that we believe any introduction of an IFRS based on this ED should only take place when similar requirements elsewhere in the world are in place, primarily in the US.

In our comments, we recommend excluding ESOPs and similar employee share participation schemes from the scope of any IFRS. We recognise this results in mixed accounting principles but believe that, in this case, this is acceptable.

These responses represent the views of AstraZeneca PLC. Should you have any queries or wish to discuss these responses further, please do not hesitate to contact Bill Hicks (+44 1625 517294) or Andy Chard (+44 1625 517279).

Yours faithfully

Bill Hicks
Chief Statutory Accountant

IASB 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?

No, we do not agree with the conclusion that there should be no exemptions. We believe that schemes approved by governments to encourage wider share ownership (such as the UK SAYE schemes) should not be included within the scope of the proposed IFRS. There are two reasons for this contention – firstly, we do not believe that participation in these schemes are analogous to remuneration and, secondly, we are concerned that, should such schemes be subject to the provisions of the IFRS, their future would be put in doubt.

We do not believe there should be an exemption for the single company stand-alone accounts of wholly-owned subsidiaries in respect of issues of shares or options over shares in the parent company. However, we believe that practical guidance should be given in how the accounting for these transactions should be undertaken. In the case of typical employee transactions, where options are granted, the answer is fairly simple – the subsidiary (wholly-owned or otherwise) would record the charge based on the fair value of the option with a corresponding increase in equity whilst the parent would record simply the proceeds received on exercise. However, in the case of non-employee transactions, which are typically share rather than option based and share-based employee transactions more guidance is necessary.

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?

We believe the proposed requirements are appropriate.

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 it not appropriate?

We believe the proposed measurement principle (i.e., fair value) is appropriate.

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?

No, we <u>do not</u> agree with the approach, for two reasons.

Firstly, we note that this approach is slightly different from the US approach in SFAS 123, which requires the fair value to be measured at the earlier of (a) the date a performance commitment is reached or (b) the date performance is complete. This means that, amongst other things, a capital commitment can be measured and disclosed reliably.

Secondly, as set out below, we do not believe that the mixed approach set out in the draft IFRS whereby transactions measured indirectly are calculated by reference to the grant date, whereas transactions measured directly are calculated by reference to the performance date. We do not believe such a distinction should be made and that all such transactions should be measured directly at the earlier of (a) the date a performance commitment is reached or (b) the date performance is complete.

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?

No, we do not agree because this results in different basis dates dependent on how a transaction can be measured, which seems counter-intuitive as set out in more detail above.

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 (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?

Yes, we agree with the approach and believe the fact that the presumption is rebuttable should deal with those situations where the fair value of the goods or services provided will be subject to an element of the risk of the success or otherwise of the issuer.

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 (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 not so?

We agree broadly with this proposal and cannot envisage any circumstances where the fair value of the employee services received would be more readily determinable. However, we suggest that the presumption is made rebuttable should such circumstances arise.

IASB 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?

We agree. Although there may be circumstances where the grant is a reflection of prior services, the presence of vesting conditions means that there is likely to be a substantive service requirement underlying the grant of the equity instruments.

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 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 do not agree with the methodology proposed. For example, the use of estimates at the grant date which are not subsequently adjusted can lead to anomalous results (in the first illustrative example, the vesting of all options would result in a lower charge than the straight multiple of the fair value of those options) whilst the ability of entities to apply their own (inevitably) subjective criteria could lead to abuse. In the appendix to this letter we set out an alternative methodology which we believe incorporates both the need to reflect a realistic annual charge and the levels of vesting failures and forfeitures. We also believe that our alternative methodology has the benefits of simplicity compared to the proposed approach in the IFRS.

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 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?

We agree with this proposed requirement..

IASB 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 agree with the proposals. However, we would like to note our concerns about the use of the likely use of the Black-Scholes method, which is more directed at traded options.

IASB 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?

We agree with the proposals.

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?

We do not agree, principally because the proposed method of adjusting the fair value of the instruments will necessarily be subjective and, accordingly, open to abuse. Our alternative approach would address the actual vesting failures.

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 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 the proposal but believe that the reload definition in the Glossary should be improved.

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?

We are not aware of any other common features. However, we would suggest revising the wording of paragraph 20 to require an entity to consider all features, rather than just those mentioned specifically, so as to cover those features that are not identified currently.

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 support the proposed approach.

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 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?

We agree that the incremental value should be recognised over the remainder of the vesting period. We believe the alternative approach, whereby the grants are averaged, is more appropriate. This approach matches the expense better and reflects the repricing of the original option instead of assuming that original option stays in place unchanged (as under the first method).

IASB 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.

We do not agree with the proposal 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. Although we understand the Board's contention that cancellation is unlikely without compensation (either in the form of cash or replacement options) there may be circumstances where this is not the case – for example, the entity's business is struggling. We agree with the approach set out for cash payments and the grant of replacement options. Therefore, we recommend that the proposals are revised to distinguish between cases where replacement options are granted (with or without cash compensation) and where no replacement options are offered. In both cases, any excess cash should be expensed immediately. In the case of replacement options being offered, these should be accounted for in accordance with the provisions of paragraph 27.

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 statement.

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

We agree with the proposed requirements.

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 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.

We agree with the proposed requirements.

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 agree with the principles set out in paragraphs 45, 47 and 51 but are concerned that the volume of disclosures required by other paragraphs would be too large and would obsure the core information that is intended to enable a reader to understand the effects of share-based payments on the entity's results. In particular, the disclosures in paragrah 48 (for example, (a) (ii)-(v)) looking how certain assumptions were used seem onerous.

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 (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.

We believe the proposed requirements are appropriate.

IASB 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 the proposed requirements are appropriate.

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, 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).*

Please refer to answer to question 1.

(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.*

As noted earlier, we do not agree with the IFRS proposed approach for dealing with forfeitures.

- *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.*

We do not believe that amounts previously recognised should be reversed on forfeiture of equity instruments. Accordingly, we do not agree with the SFAS 123 approach.

(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.

Please refer to our answer to question 18.

(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.*

We support the EITF 96-18 approach.

(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).*

We support the proposed approach in the IFRS.

(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.

IASB Question 25

Do you have any other comments on the Exposure Draft?

No.

Appendix – Methodology for Accounting for Stock Options

Under the proposed methodology, the number of options outstanding are averaged for each reporting period and the resulting charge taken through profit and loss. There is to true-up for options that do not vest subsequently or are forfeited.

10,000 options are issued with a fair value of $5 and the grants are conditional upon the relevant employees working for the next three years. Over the vesting period certain options are forfeited or fail to vest as set out in the table below. The charges will be as follows:

Year	Options outstanding at start of year	Options outstanding at end of year	Average number of options	Average value of options $	Charge for year	Total charge
1	10000	7000	8500	42500	14167	14167
2	7000	6500	6750	33750	11250	25417
3	6500	6000	6250	31250	10417	35834

This proposed method would result in a charge to the profit and loss each year, reflecting the number of executives on the option scheme for that year. The total charge over the three years will be the sum of these charges, and would give a more realistic representation of the total benefit gained from all executives having the options over the period of the scheme.

In the table above the average is assumed to be on a straight line basis i.e., the forfeitures and vesting failures are spread evenly through the year. However, the weighted average should be used, in the same way that the weighted average number of shares is calculated for earnings per share disclosures.