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UBS

UBS AG
Financial Services Group
P.O. Box
CH-8098 Zürich
Tel. +411-234 11 11

Group Tax and Accounting Policies

William Widdowson
Tel. + 41 1 234 55 66
Fax +41 1 234 20 44

William.Widdowson@ubsw.com

Sir David Tweedie
Chairman
International Accounting Standards
Board (IASB)
30 Cannon Street
London EC4M 6XH
United Kingdom

March 7, 2003

RE:ED 2 **Share-based Payment**

Dear Sir David:

UBS AG appreciates the opportunity to comment on the Exposure Draft 2, *Share-based Payment.* UBS AG utilises IAS as its primary reporting framework and is one of the largest companies of any kind to have adopted IAS. We are thus keenly interested in the work of the IASB and are cognisant of the need for high quality accounting standard, which facilitate the international comparability of financial statements. We hope you find our comments useful.

We support the view taken by the IASB that it is appropriate to recognise the fair value of share-based payment transactions when the goods or services received or acquired are consumed. However, we acknowledge that there are several shortcomings in the proposed measurement and recognition requirements outlined in the exposure draft. In particular we strongly oppose the units of service method. We do not believe that this method accurately reflects the economic reality of share-based payment transactions. This approach will lead to misleading results, as the total recorded compensation expense will vary based on an entity's forfeiture estimates. Furthermore, we believe that this method is burdensome for entities to implement and will be difficult for investors to interpret and understand.

We do not agree with the presumption in the Exposure Draft that vesting period equals service period. Many of the award plans effective in our organisation are based on the performance of the employee and the organisation in the period prior to the grant date. We believe that the strict requirement to equate service period with vesting period is contradictory to the IASB's service based approach. We believe that compensation expense should be recognised over the service period, which should be determined based on the substance, facts and circumstances of each equity based compensation plan. We recommend that the board amend this rule to at least state that there is a presumption that service period equals vesting period and leave it to the individual organisation to refute this presumption.

We do not agree with the proposed guidance for accounting for forfeitures and cancellations. We believe that the total amount of compensation expense recognised for an award of share-based compensation should be based on the number of instruments that eventually vest. Compensation expense should be measured and recognised based on the fair value of equity instruments issued. We do not believe that an award is issued until all of the vesting conditions have been fulfilled. Employees do not become unconditionally entitled to awards until all vesting and/or performance conditions have been met. Likewise the entity that grants the award does not receive an enforceable right to the employee services at the grant date. We believe that ultimate delivery is the most important concept when determining total compensation expense. We are especially concerned about how the units-of-service method would impact performance-based grants. We believe that the services necessary to receive performance-based awards are only obtained if the performance-related criteria are met. As such, we believe that if forfeiture occurs due to failure to achieve the performance target, the services have not been received and no expense should be recorded on the entity's books. Under the Exposure Draft an expense would be recorded although no service would have been received. We believe that the IASB's approach to performance based awards is completely contradictory to the service based method of recording expense. We would view performance-based awards to be contingent compensation plans and that the accounting for contingencies should be followed. These contingent compensation plans should be assessed continually to determine whether a provision should be made based on the best estimate of the total equity instruments ultimately delivered. We endorse a modified grant-date measurement method that combines attributes of both grant date and vesting date measurement.

We agree with the IASB that share-based awards issued to employees should be measured at the grant date. However, we believe that grant date measurement should be extended to all share-based awards. Grant date measurement should be used for employee and non-employee transactions irrespective of whether the fair value of the award is measured by reference to the goods/services received or the equity instruments granted. We believe that it is reasonable to presume that the full value of the economic benefits to be received in exchange for equity instruments granted are contemplated by the entity and the counterparty at the time the arrangement was entered into. As such, at the grant date the monetary economic benefits to be received are substantially equal to the fair value of the equity instrument granted.

We have included our response to the specific questions asked in the Invitation to Comment in Appendix A of this letter.

We very much appreciate the opportunity to comment. If you would like to discuss any comments that we have made, please contact us at your convenience. Your contacts on the subject are Ralph Odermatt, Managing Director (+41-1- 236-8410) and John Gallagher, Executive Director (+1 -203-719-42 12).

Yours sincerely,

UBS AG

Hugo Schaub
Group Controller

William Widdowson
Managing Director
Group Tax and Accounting Policies

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 transactions within the scope of another IFRS. Is the proposed scope appropriate? If not, which transactions should be excluded and why?

Answer: We believe that employee stock purchase plans (ESPPs) should be excluded from the scope of ED-2. The purpose of ESPPs is to promote employee stock ownership and are not viewed by the entity or its employees as compensatory. The discount received by employees typically offset the costs, such as underwriting or brokerage fees, and replicates the capital structuring discount that would be required by an issuance of similar size if they were to publicly issue the shares. As such, we recommend that the Board revise the ED to exclude ESPPs from its scope.

We acknowledge the IASB's difficulty in specifying a scope exclusion due to problems in defining what constitutes a "small" discount in a principles based approach. However, from a practical standpoint, we believe that a specific scope exclusion for ESPPs would be beneficial as it would promote consistency in the application of this standard and reduce the operational difficulties of having to support on a continuous basis that the amounts in question are immaterial. We believe that the conditions that the FASB requires for ESPPs to be excluded from the scope of SFAS 123, *Accounting for Stock-Based Compensation,* are reasonable and should be included in ED-2. These conditions include the following:

A. The plan cannot incorporate any option feature other than the following:
   1. Employees are permitted a short period of time – not exceeding 31 days – after the purchase price has been fixed to enroll in the plan.
   2. The purchase price is based solely on the stock’s market price at date of purchase, and employees are permitted to cancel participation before the purchase date and obtain a refund of amount previously paid.

B. The discount from the market price does not exceed the greater of (1) a per-share discount that would be reasonable in a recurring offer of stock to stockholders or others or (2) the per share amount of stock issuance costs avoided by not having to raise a significant amount of capital by a public offering. A discount of five percent or less from the market price shall be considered to comply with this criterion without further justification.

C. Substantially all full-time employees that meet limited employment qualifications may participate on an equitable basis.

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?

Answer: We agree with the requirement that an entity recognise goods and services when they are consumed. This is a concept that is understood by all financial statement preparers and is in line with the basic principle of matching costs with revenues as defined in the IASB framework.

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?

Answer: We believe it is appropriate for all equity-settled share-based payment awards to be measured at fair value, and agree that there should be no exemptions from this requirement. Although the estimation of volatility on non-public companies is subjective, we agree with the IASB that there are several methods available to estimate expected volatility. We firmly believe that the financial markets have advanced to a stage where fair value can be reasonably and adequately determined regardless of whether or not an entity is listed or unlisted. While we agree that quoted market prices represent the best evidence of fair value for instruments that are listed in an active market or exchange traded, we believe that fair value can be can be reasonably determined for virtually any financial instrument, including options on non-traded companies.

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?

Answer: We disagree that the fair value of goods and service that are measured directly should be measured at the date when an entity obtains the goods or receives the services. We observe that there is no conceptual difference between an employee and non-employee transaction and therefore recommend that grant date measurement be used for both types of transactions irrespective of whether the fair value of the award is measured by reference to the goods/services received or the equity instruments granted. We believe that it is reasonable to presume that the full value of the economics to be received in exchange for equity instruments granted was contemplated by the entity and the counterparty at the time the arrangement was entered into. As such, at the grant date the monetary value of the economic benefits to be received is substantially equal to the fair value of the equity instruments granted. We understand that based on a unit of service model why the IASB proposes to use the date that the entity obtains the goods or services as the measurement date. However, as further explained in our response to Questions 9 and 10 we strongly disagree with the unit of service model. We therefore recommend that the Board adopt the grant date as the measurement date for all equity settled share based payment transactions.

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?

Answer: We agree with the Boards' proposal for the reasons provided in the Basis for Conclusion and in our response to Question 4 above.

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?

Answer: We support the IASB's inclusion of a rebuttable presumption that the fair value of goods or service is generally more readily determinable that the fair value of equity instruments granted. While we believe that an entity can reasonably determine the fair value of any equity instrument we agree that the most reliable fair value should be used to determine compensation cost.

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?

Answer: We agree with the Boards' proposal for the reasons provided in the Basis for Conclusion.

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?

Answer: We agree with the concept that expense should be attributed to the period in which services are performed and note that there are many plans for which the service period equals the vesting period. An example of this would be when an award is provided as a retention award to a new employee to ensure the employee stays within the organisation for a certain period of time. As this retention award is "not earned" by the employee at grant date, the value of the award should be amortised over the life of the vesting period. However, there are plans where the grant relates to past services performed, despite the fact that there may be a vesting period. We believe that the requirement always to equate service period with vesting period is contradictory to the principles based approach adopted by the IASB. We believe that compensation expense should be recognised over the service period, which should be determined based on all of the substance, facts and circumstances of each equity based compensation plan. We recommend that the board amend this rule to state at most that there is a presumption that service period equals vesting period and leave it to the individual organisation to refute this presumption.

In our opinion, stock awards are fungible with various other forms of employee compensation such as cash, alternative investment vehicles, allowances for autos and club memberships, etc. Employees expect a total compensation figure for service performed during the year and stock-based compensation is used as a means to achieve this total. Awards granted may be based simply on the performance of the employee and company for the current year and not based on the expectations of services to be received in the future. Companies and their employees generally view awards as compensation for past performance. Employees are typically selected to participate in certain plans as a result of their past performance. As such we believe that a significant portion of these plans should be expensed in the year of grant. While we would agree that there may be an employee retention benefit (for which value may be measured by a liquidity factor) obtained during a vesting period, we believe that this amount is often immaterial in relation to the services performed by the employee during the grant year. If a company can demonstrate that the preponderance of the value to be received by the company from employees is from services already rendered it is a radical step to require that corresponding expense recognition driven by the less significant aspect (i.e. vesting period) of the award.

In order to assist companies in determining whether an award is for past or future service, we recommend that the IASB consider providing further guidance in this area. We believe that the following should be considered in determining whether an award is for past or future service:

a.) Is the award based on the prior period (i.e. the period before grant date) performance of the employee or entity? If the award were determined predominantly on a formula based on prior period performance, it would indicate that the service is for past performance.
b.) Does the forfeiture clauses require an employee to continue working for the entity? If there is no requirement for an employee to continue working for an entity in order to receive their award, there is no direct linkage to future revenue. As such it would indicate that the award is based on past services.
c.) Is the purpose of the award for retention of the employee, or is it to further align the goals of the employee with the goals of the company? If the purpose of the award is to retain employee then the expense should be amortised over the vesting period.
d.) Is the award granted at the discretion of management? If the award is granted without any linkage to the past performance of the company this would indicate that the award is for future service.

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?

Answer: We disagree with the units-of-service method proposed by the IASB. This method has the ability to distort comparability between entities as the total expense booked varies significantly based on the forfeiture assumptions used to obtain the price per unit of service. As such, two entities with identical plans and identical actual forfeiture rates may book completely different expense amounts if upon initial determination of the cost per unit of service, they estimate different forfeiture results.

Furthermore, there are many plans whereby employees can leave the entity and retain their awards. If the units of service method were applied to grants that permit employees to retain their awards if they leave the entity before vesting, the entity would not be required to record any expense over the remaining vesting period as no services would be received. This would occur even though the employees would still receive their awards.

The units-of-service method would also be too burdensome for entities to implement. Most entities do not have the systems in place to track forfeitures in such a detailed manner as would be required by the Exposure Draft. Implementation of systems capable of obtaining the necessary information to apply the service units method would be extremely expensive. Additionally, it would be difficult to track service units received by employees who transfer across segments within the organisation.

As an alternative to the units of service method, we would strongly encourage the Board to adopt the recognition principles used under US GAAP. This recognition principle uses the concept of issuance: that is, equity instruments are not issued until the issuer has received valuable consideration in exchange for the equity instruments and those equity instruments are ultimately issued. As a result, equity instruments subject to service or performance conditions represent a conditional obligation to issue equity instruments in exchange for valuable consideration (i.e. employee services) at a later date. Therefore, under US GAAP, compensation expense for share based awards are based on the actual number of equity instruments ultimately issued. No compensation expense is recognised for instruments granted that are not issued because of failure to achieve service or performance conditions.

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, 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?

Answer: We do not agree with the units-of-service method proposed by the IASB. We believe that the total expense booked by an entity should be based on the total equity instruments ultimately delivered. As a result, entities should be allowed to reverse previously booked expense in the event of forfeitures. We believe that an entity should only be required to recognise the fair value of goods and services received in exchange for equity instruments actually distributed. No compensation cost should be recognised for instruments granted that are not distributed because of failure to achieve service, performance or vesting conditions. We would like to point out that it is often the case that when an employee leaves an organisation and forfeits their award their new employer gives them a substantially equal award. The units of service method will result in expense being booked by two separate organisations for essentially the same services even though only one award would be ultimately granted.

We are especially concerned about how the units-of-service method would impact performance-based grants. We believe that the services necessary to receive performance-based awards are only obtained if the performance-related criteria are met. As such, we believe that if forfeiture occurs due to failure to achieve the performance target, the services have not been received and no expense should be recorded on the entity's books. Under the Exposure Draft an expense would be recorded although no service would have been received. We believe that the IASB's approach to performance based awards is completely contradictory to the service based method of recording expense. We would view performance-based awards to be contingent compensation plans and that the accounting for contingencies should be followed. These contingent compensation plans should be assessed continually to determine whether a provision should be made based on the best estimate of the total equity instruments ultimately delivered.

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?

Answer: We agree that an option-pricing model should be applied to estimate the fair value of options granted. Option pricing models are widely used and accepted by the investment community, and have been proven in practice to develop reasonable and reliable valuations. These models are also accepted globally by regulators as a tool to measure risk. Because new option models may be developed in the future, we do not believe that the standard should mandate the use of any one specific model. Additionally, due to the variety and complexity of share-based award plans, we propose that the standard permit entities flexibility to apply modifications to the outcomes of option pricing models in order to reflect specific plan conditions (e.g. performance conditions) as long as they can be reasonably supported and explained.

We do not believe that there are any circumstances where it would be inappropriate or impracticable to take into account the factors listed above in applying an option pricing model. However, we would however like to point out that global market practice for valuing tradable options uses a LIBOR-based rate as the risk-neutral discount rate variable input in option pricing models. As currently written, the standard requires entities to use the risk free interest rate which as stated in paragraph IG30 is the implied yield currently available on zero-coupon government issues, in the country in which the entities shares are traded, with a remaining term equal to the expected life of the option being valued. We believe it is more appropriate to use the same rate as the market in order to get an accurate fair market valuation for options. As such, we recommend that the Board amend the standard to require entities to use the interest rate curve that is used by market convention.

Answer: For the reasons given in the Basis for Conclusions, we agree that replacing an options contracted life with its expected life is a reasonable means of adjusting the options fair value for the effects of non-transferability.

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?

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 believe that it is appropriate to consider forfeitures when determining the amount of total compensation expense that should be recognised. However, we disagree with the IASB's approach to incorporate forfeitures into the estimate of per equity instrument fair value and attribute that amount using the units of service method. We do not believe that forfeitures affect the value of an equity instrument at grant date. As more fully discussed in our responses to Questions 9 and 1 0, we are opposed to the units of service model proposed in this Exposure Draft.

We support an approach whereby the effects of forfeitures are addressed through the notion of issuance. We believe that expected forfeitures should be estimated at the grant date and the number of equity instruments expected to be delivered should be adjusted for this expectation. Furthermore, a true up should be required to ensure that the total expense recorded by an entity reflects the total equity awards ultimately delivered.

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?

Answer: For the reasons provided in the Basis of Conclusions, we agree with the IASB's proposal regarding accounting for reload features. We agree with the broad principle that all features associated with an option grant should be taken into consideration when estimating its fair value. We believe that it would be very unlikely that an entity would be unable to reasonably determine the fair value of options at date of grant.

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?

Answer: We have not identified any other common features of employee share options for which the standard should specify requirements.

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?

Answer: For the reasons provided in the Basis of Conclusions, we agree with the IASB's approach not to provide prescriptive guidance on the estimation of the fair value of options.

Question 17 If an entity reprices a share option, or otherwise modifies the terms or conditions on which equity instruments were granted, the draft IFRS proposes that the entity should measure the incremental value granted upon repricing, and include that incremental value when measuring the services received. This means that the entity is required to recognise additional amounts for services received during the remainder of the vesting period, ie additional to the amounts recognised in respect of the original option grant. Example 3 in Appendix B illustrates this requirement. As shown in that example, the incremental value granted on repricing is treated as a new option grant, in addition to the original option grant. An alternative approach is also illustrated, whereby the two grants are averaged and spread over the remainder of the vesting period. Do you agree that the incremental value granted should be taken into account when measuring the services received, resulting in the recognition of additional amounts in the remainder of the vesting period? If not, how do you suggest repricing should be dealt with? Of the two methods illustrated in Example 3, which is more appropriate? Why?

Answer: If the units-of-service method is retained, we agree that the incremental value granted should be taken into account when measuring the services received. Of the two methods illustrated we believe that the alternative approach whereby the two grants are averaged and spread over the remainder of the service period is the more appropriate. We believe that this approach better reflects the economics of what has occurred, as it would attribute the expense evenly over the remaining service period. This approach better reflects that a re-pricing of the options occurred.

We do however believe that the alternative approach should be changed to explicitly state that the average of the two grants should be spread over the remainder of the service period, not the vesting period. As further discussed in our response to Question 8, we do not believe that it is appropriate to assume that the vesting period equals the service period.

In order to promote comparability we believe that as a general rule that the number of alternative accounting approaches should be kept to a minimum. As a result, we strongly urge the IASB to accept only one method to account for a modification in the terms and conditions of an equity grant.

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.

Answer: We do not agree that an entity should continue to recognise expense for services received when an option or share grant is cancelled. As discussed in our response to Question 10, we believe that expense should be based on the total equity investment ultimately delivered. If a plan is cancelled, we do not believe that an expense should be recorded. We believe that an alternative method of could be a straight-line amortisation of the fair value of the equity instruments granted, trued up at each reporting date for actual forfeitures and changes in the forfeiture assumptions. We believe that forfeitures should be considered in estimating compensation costs, but total expense over the service period should take into consideration actual forfeitures, including the cancellation of plans. We support the FASB notion of issuance. We agree with the conclusions under SFAS 123 that the cost of the services received should be measured and recognised based on the fair value of the equity instruments distributed. The employee does not become unconditionally entitled to a stock based award until all vesting and/or performance conditions have been met. Likewise the entity that grants the award does not receive an enforceable right to the employee service at the grant date. We believe that ultimate delivery is the most important concept when determining total compensation expense.

If this alternative method is accepted, companies should be prohibited from canceling one plan and issuing another with the objective of reducing compensation expense. If a plan is cancelled with the objective of issuing a similar plan at a lower price in the near future or as a result of a new award recently issued, companies should be required to continue recording expense under the original terms. If an award is granted with a price below the cancelled award, that award and the cancelled award should be combined. As a result, compensation expense for a new plan replacing an existing plan should be of equal or greater value than the compensation expense under the original plan.

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.

Answer: We agree that for cash settled share-based payment transactions the entity should measure the goods or services acquired and the liability incurred at the fair value of the liability, and should re-measure this amount at each reporting date until settled. As cash-settled transactions result in the distribution of an asset of the entity, we agree that it is important that the true liability be reflected on the entity's books at each reporting date.

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.

Answer: We agree that the proposed requirements are appropriate. The proposed accounting would follow the substance of the components of the transaction, which is in line with the IASB's principles based approach.

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)?

Answer: Overall we believe that the broad principles outlined in paragraphs 45, 47, and 51 of the Exposure Draft are appropriate, however the detailed disclosure requirements are excessive. We are sceptical whether the detailed disclosure requirements will provide additional benefits to users of financial statements. Specifically, we do not believe that it is necessary to disclose the number and class of employees participating in all types of share-based payment arrangements. Entities may have numerous types of plans, many of which are immaterial in relation to other plans. We believe that disclosure about certain plans may hinder an entities competitive advantage and will provide no useful information to users of financial statements. Furthermore, we do not believe that the level of detail described in paragraph 48 of the exposure draft is necessary for users of the financial statements to understand how the fair value of the equity instruments granted was determined. We believe that this level of detail is overly burdensome to preparers and will not necessarily provide users of financial statements with information that is useful.

We believe that preparers of financial statements should be in the position to determine what information is needed to be disclosed in order for a reader of the financial statements to understand the broad principles outlined in paragraphs 45, 47 and 51. As a result we recommend that paragraph 46 and 48 of the Exposure Draft be deleted.

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.

Answer: We disagree with the proposed requirements. We believe that the IFRS should apply to grants of equity instruments that are made after the publication of a final standard and not the publication date of the Exposure Draft. Entities often structure their business around accounting rules in an effort to achieve a desired result. As such, entities have structured their current sharebased compensation arrangements around the current rules as defined in AS 19, *Employee Benefits.* We believe that companies should be given sufficient time to develop new plans to coincide with the proposed rules. As such we recommend that the IASB revise the transition rules to apply to any grant made after the publication of a final standard, with early adoption permitted.

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?

Answer: No. We believe that when realised tax benefits from equity awards exceed the recorded tax benefits on the cumulative amount of stock based compensation expense recognised, it should be credited to stockholder's equity. Likewise, if the realised tax benefits are less than the recorded tax benefits, this difference should also be recorded in stockholder's equity. We believe that the accounting for all tax benefits derived from stock-based compensation should be symmetrical. We do not support the IASB view that these tax benefits are a result of an income statement item (i.e. compensation expense), and therefore should be reflected in the income statement. We take the view that these tax benefits are a result of the issuance of equity based instruments, and therefore should be reflected in equity. A consequence of the IASB approach is that an entity may recognise income in excess of the cumulative compensation expense. We believe that recognising income as a result of the appreciation in the value of equity instruments granted in a share-based award is not appropriate.

Question 24 In developing the Exposure Draft, the Board considered how various issues are dealt with under the US standard SFAS 123 Accounting for Stock- Based Compensation, as explained further in the Basis for Conclusions. Although the draft IFRS is similar to SFAS 123 in many respects, there are some differences. The main differences include the following.

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

- employee share purchase plans are excluded from SFAS 123, provided specified criteria are met, such as the discount given to employees is relatively small;
- SFAS 123 encourages, but does not require, entities to apply its fair value measurement method to recognise transactions with employees; entities are permitted to apply instead the intrinsic value measurement method in Accounting Principles Board Opinion No. 25 Accounting for Stock Issued to Employees (paragraphs BC70- BC74 in the Basis for Conclusions give an explanation of intrinsic value); and
- unlisted (non- public) entities are permitted to apply the minimum value method when estimating the value of share options, which excludes from the valuation the effects of expected share price volatility (paragraphs BC75- BC78 in the Basis for Conclusions give an explanation of minimum value).

b. For transactions in which equity instruments are granted to employees, both SFAS 123 and the draft IFRS have a measurement method that is based on the fair value of those equity instruments at grant date. However:

- under SFAS 123, the estimate of the fair value of an equity instrument at grant date is not reduced for the possibility of forfeiture due to failure to satisfy the vesting conditions, whereas the draft IFRS proposes that the possibility of forfeiture should be taken into account in making such an estimate.
- under SFAS 123, the transaction is measured at the fair value of the equity instruments issued. Because equity instruments are not regarded as issued until any specified vesting conditions have been satisfied, the transaction amount is ultimately measured at the number of vested equity instruments multiplied by the fair value of those equity instruments at grant date. Hence, any amounts recognised for employee services received during the vesting period will be

subsequently reversed if the equity instruments granted are forfeited. Under the draft IFRS, the transaction is measured at the deemed fair value of the employee services received. The fair value of the equity instruments granted is used as a surrogate measure, to determine the deemed fair value of each unit of employee service received. The transaction amount is ultimately measured at the number of units of service received during the vesting period multiplied by the deemed fair value per unit of service. Hence, any amounts recognised for employee services received are not subsequently reversed, even if the equity instruments granted are forfeited.

c. If, during the vesting period, an entity settles in cash a grant of equity instruments, under SFAS 123 those equity instruments are regarded as having immediately vested, and therefore the amount of compensation expense measured at grant date but not yet recognised is recognised immediately at the date of settlement. The draft IFRS does not require immediate recognition of an expense but instead proposes that the entity should continue to recognise the services received (and hence the resulting expense) over the remainder of the vesting period, as if that grant of equity instruments had not been cancelled.

d. SFAS 123 does not specify a measurement date for transactions with parties other than employees that are measured at the fair value of the equity instruments issued. Emerging Issues Task Force Issue 96- 18 *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services*, requires the fair value of the equity instruments issued to be measured at the earlier of (i) the date a performance commitment is reached or (ii) the date performance is complete. This date might be later than grant date, for example, if there is no performance commitment at grant date. Under the draft IFRS, the fair value of the equity instruments granted is measured at grant date in all cases.

e. SFAS 123 requires liabilities for cash- settled share appreciation rights (SARs) to be measured using an intrinsic value measurement method. The draft IFRS proposes that such liabilities should be measured using a fair value measurement method, which includes the time value of the SARs, in the same way that options have time value (refer to paragraphs 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.)

Answer

a.

- As stated in our response to Question 1, we agree with the FASB's scope exclusion relating to employee share purchase plans and believe the IASB should adopt a similar approach.
- We disagree with the FASB's approach to permit an alternative accounting method and believe that all entities should be required to adopt a fair value measurement approach to account for share-based compensation. The granting of equity instruments to employees in recognition of services performed or for future services should be recognised as an expense. The value of these equity instruments should be recognised in the period that the services relate. Ignoring the value associated with these equity instruments is an unsound accounting practice.
- We disagree with the FASB's conclusion to allow non-public companies to apply the minimum value method when estimating the value of share options. Ignoring the effects of volatility on an option as required by the minimum value approach could significantly understate the value of the equity instrument. Although the estimation of volatility on non-public companies is subjective, we agree with the IASB that there are several methods available to estimate expected volatility. Using an estimate of volatility would still produce a value closer to fair value than the minimum value approach, which does not take into account volatility at all. As stated in our response to Question 3 we firmly believe that a reliable fair value can be determined for non-public companies.

b.

- We believe that it is appropriate to consider forfeitures when determining the amount of total compensation expense that should be recognised. We support the FASB approach whereby the effect of forfeitures is addressed through the notion of issuance. We believe that forfeitures do not affect the value of an equity instrument at issuance and that total compensation cost should be based on the number of equity instruments actually distributed. As such, we support an approach of estimating the amount of equity instruments expected to be forfeited and truing up that estimate based on actual forfeitures.

  We support the FASB notion of issuance. We agree with the conclusions under SFAS 1 23 that the cost of the services received should be measured and recognised based on the fair value of the equity instruments distributed. The employee does not become unconditionally entitled to a stock based award until all vesting and/or performance conditions have been met. Likewise the entity that grants the award does not receive an enforceable right to the employee service at the grant date. We believe that ultimate delivery is the most important concept when determining total compensation expense.

c. We agree with the FASB's approach to recognise immediately upon settlement compensation costs associated with an equity transaction that is settled in cash. We disagree with the IASB’s approach to continue to recognise services received for equity transactions that an entity settles in cash. As previously stated, we disagree with the IASB's service based approach. We do not agree with the IASB's focus on measuring the changes in net assets that result when goods or services are received. If cash is distributed to settle an equity transaction, the entity has realised a change in net assets and as such should record an expense for that.

d. We believe that grant date measurement should be used to determine the value of all share based payment transactions as this method most accurately reflects the economics of the situations. We do not support the measurement date criteria described in Issue 96-18. This method has the ability to assign substantially different fair values to the same goods or services, thereby distorting the economic reality of the transaction. We believe that it is reasonable to presume that the full value of economic benefits to be received in exchange for equity instruments granted was contemplated by the entity and the counterparty at the time the arrangement was entered into. As such, the monetary value of the economic benefits to be received is substantially equal to the fair value of the equity instruments granted. As such, we support grant date measurement regardless if they are measured by reference to the fair value of the goods and services or the fair value of the equity instruments received.

e. For the reasons provided in the Basis for Conclusions, we agree with the Exposure Draft that SARs should be valued using a fair value measurement method.

f. As further explained in our response to Question 23 we believe that the difference between the realised tax benefit and the recorded tax benefits should be recorded in stockholders equity.

Question 25 Do you have any other comments on the Exposure Draft?

We would like to emphasise our disagreement with the units-of-service approach proposed by the IASB, and urge adoption of the issuance concept currently effective under SFAS 123.