



## **EXPENSING AND VALUATION OF OPTIONS – ASIC SPOT CHECKS**

In many Australian companies, grappling with the preparation and lodgement of their annual company accounts with ASIC, and the ASX, the valuation of their employee share and option benefits will come as a bit of a shock. For the bulk of Australian companies with employee share and option plans, preparing accounts for the year ended 30<sup>th</sup> June 2005, valuations of employee shares and options will need to be prepared for the first time.

Many companies have left the calculation of their option and other equity values until the last minute.

It has come to RSG's attention, that the Australian Securities and Investments Commission (ASIC) will be conducting "Spot" checks on the value of options and other employee equity disclosed in the accounts of companies listed on the Australian Stock Exchange.

Under the accounting standards, the employee share and option benefits will need to be valued, disclosed in accounts prepared from 1<sup>st</sup> July 2004 and expensed in the profit and loss accounts of those companies prepared from 1<sup>st</sup> January 2005.

The initial impact will fall on so-called "disclosing entities" (e.g. ASX listed companies and companies issuing prospectuses) but, ultimately, it will apply to nearly all companies of all sizes under the expensing requirements of AASB 2.

RSG has developed an employee equity valuation calculator (i.e. the RSG Employee Equity Calculator), in conjunction with a noted academic from a leading university, who specialises in the valuation of options and other equity. The valuation of employee share options and all forms of employee equity needs to be based on the methods outlined in the AASB 2, which is the Black and Scholes model or a binomial model, with a careful and detailed calculation of the valuation volatility factors.

The RSG Employee Equity Calculator incorporates a 250 step, binomial tree structure, which allows for inclusion of employee vesting conditions, employee turnover rates and early exercise as required by the accounting standards.

It is the determination of the volatility factor that is one of the keys to accurately value share options and other equity. Volatility represents the potential for the option and share benefits to grow in value over the period the employees hold the equity. Accurate determination of the appropriate volatility requires careful analysis of the fluctuations in the company's share prices.

Where a company has little in the way of historical valuation data, it is understood ASIC is applying an arbitrary volatility factor of 65%. Most mature companies exhibit a volatility factor of around 20-30%. However, newly established, more speculative mining or hi-tech companies can exhibit unsustainable volatility factors in excess of 100%.

If picked up under an ASIC spot check, companies will need to justify their employee option and other equity valuation calculations to ASIC investigators.

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It should be emphasised that the valuation of share-based payments are not limited to employee option plans. For example, many companies have loan share plans (i.e. employees are given an interest free loan by their employer to invest in the company's shares) and they will also need to disclose and expense the value of this equity. Generally speaking, the value of employee loan plans can be determined on a similar basis to employee option plans.

If you wish to have your option valuation calculations prepared or checked by RSG utilising its calculator, please phone us on our office number (03) 9650 6599 and ask to speak to Gary Fitton or John Day.