

AASB 2 Impact on ANZ Reward

Share Based Payments

Overview of changes

- IFRS 2 Share-based Payment was published by the International Accounting Standards Board (IASB) in February 2004 and was adopted by the Australian Accounting Standards Board as AASB 2
- AASB2 determines how share-based awards for reporting periods beginning on or after 1 January 2005 will be expensed
- The standard requires that the “fair value” of share awards and share options when they are granted be charged to the profit and loss account over the vesting period
- Under AGAAP, ANZ did not recognise an expense for options issued to staff and shares issued under the \$1,000 employee share plan. However, deferred share issues were fully expensed up-front
- Performance Rights were not introduced at ANZ until October 2005 and will be recognised as an expense under AASB 2

Market vs Non-Market Based Conditions

Market Based

- Market based performance conditions are conditions which are related to the company's share price, eg TSR
- ANZ determines the fair value at the start of the vesting period **based on the probability of meeting the market condition***
- The final expense/P&L charge **is not** further adjusted to reflect the actual vesting of awards based on not meeting the market condition

Non-Market Based

- Non market based conditions are not related to share price performance (eg. service conditions, EPS)
- ANZ initially estimates the number of shares that it expects to vest and accordingly adjusts the P&L charge
- The final charge to the P&L account is based on the actual number of shares which eventually vest and their original fair value

Awards may be subject to both market and non-market based conditions. Eg ANZ hurdled options and Performance Rights are contingent on TSR hurdles and continued employment.

**ANZ uses a Binomial option pricing model to assess the fair value of their options. This takes into account any performance hurdles and the non-transferability of the options*

Example – Treatment of deferred shares AGAAP vs AASB 2

Assumptions:

- A grant of 5000 shares made at the beginning of year 1, to be held for 3 years
- The value for disclosing and expensing (1 day volume weighted average price) is \$24
- ANZ estimates that 20% of shares will be forfeited over the 3 year period due to employees leaving and forfeiting their shares. ANZ revises this estimate during year 1 to 15% and further revises it during year 2 to 12%. At the end of year 3, 10% of shares have been forfeited under the scheme. i.e. the total number vesting is 4,500.

AGAAP:

Year 1	Year 2	Year 3	Total P&L Charge
\$120,000	-	-	\$120,000

AIFRS - AASB 2:

	Year 1	Year 2	Year 3	Total P&L Charge
Total to be charged over period (5,000 x \$24)	\$120,000	\$120,000	\$120,000	
"Trued up" for forfeitures	\$102,000	\$105,600	\$108,000	
Multiplied by portion of vesting period expired	1/3	2/3	3/3	
Amount to be expensed up to this point	\$34,000	\$70,400	\$108,000	
Minus what has already been charged	\$0	\$34,000	\$70,400	
Amount expensed in year	\$34,000	\$36,400	\$37,600	\$108,000

Example – Treatment of hurdled options under AGAAP vs AASB 2

Assumptions:

- A grant of 5000 options made at the beginning of year 1, with a three year performance period/expected vesting period
- Scaled vesting applies with 50% vesting for median performance and 100% vesting for upper quartile performance
- The initial fair value calculated at date of grant, adjusted to take into account the performance condition is \$3.00
- ANZ estimates that 20% of shares will be forfeited over the 3 year period due to employees leaving and forfeiting their shares. ANZ revises this estimate during year 1 to 15% and further revises it during year 2 to 12%. At the end of the year 3, 10% of shares have actually been forfeited under the scheme. i.e. the total number vesting is 4,500.

AGAAP: Under AGAAP, ANZ did not recognise options as an expense.

Example – Treatment of hurdled options under AGAAP vs AASB 2

Under AASB 2, no matter what proportion of the award vests based on the market condition, the P&L cost will reflect the initial “fair value” of the TSR condition as the possibility that the TSR hurdle may not be achieved **has already been taken into account** when estimating the fair value at grant date. ANZ will prorate the fair value of the TSR condition over the vesting period, and proposes to “true up” each year to reflect revised estimates for total forfeitures and the final number actually forfeited at the end of the period e.g.

AASB 2 Scenario 1: 100% of award vests based on achievement of market based condition .

	Year 1	Year 2	Year 3	Total P&L Charge
Total to be charged over period (5,000 x \$3)	\$15,000	\$15,000	\$15,000	
"Trued up" for forfeitures	\$12,750	\$13,200	\$13,500	
Multiplied by portion of vesting period expired	1/3	2/3	3/3	
Amount to be expensed up to this year	\$4,250	\$8,800	\$13,500	
Minus what has already been charged	\$0	\$4,250	\$8,800	
Amount expensed in year	\$4,250	\$4,550	\$4,700	\$13,500

AASB 2 Scenario 2: 60% of award vests based on achievement of market based condition .

	Year 1	Year 2	Year 3	Total P&L Charge
Total to be charged over period (5,000 x \$3)	\$15,000	\$15,000	\$15,000	
"Trued up" for forfeitures	\$12,750	\$13,200	\$13,500	
Multiplied by portion of vesting period expired	1/3	2/3	3/3	
Amount to be expensed up to this year	\$4,250	\$8,800	\$13,500	
Minus what has already been charged	\$0	\$4,250	\$8,800	
Amount expensed in year	\$4,250	\$4,550	\$4,700	\$13,500

Example – Treatment of ANZ Performance Rights under AGAAP

Assumptions:

- A grant of 5000 Rights made at the beginning of year 1, with a three year performance period/expected vesting period
- Scaled vesting applies with 50% vesting for median performance and 100% vesting for upper quartile performance
- The initial fair value calculated at the date of grant, adjusted to take into account the performance condition is \$12.00
- ANZ estimates that 20% of shares will be forfeited over the 3 year period due to employees leaving and forfeiting their shares. ANZ revises this estimate during year 1 to 15% and further revises it during year 2 to 12%. At the end of the year 3, 10% of shares have actually been forfeited under the scheme. i.e. the total number vesting is 4,500.

AGAAP: Performance Rights were not introduced at ANZ until October 2005, after the adoption of AASB2.

Example – Treatment of ANZ Performance Rights under AASB 2

Similar to options, under AASB 2, no matter what proportion of the award vests based on the market condition, the P&L cost will reflect the initial “fair value” of the TSR condition, as the possibility that the TSR hurdle may not be achieved **has already been taken into account** when estimating the fair value. ANZ will prorate the fair value of the TSR condition over the vesting period, and proposes to “true up” each year to reflect revised estimates for total forfeitures over the period and the final number actually forfeited at the end of the period e.g.

AASB2 Scenario 1: 90% of award vests based on achievement of market based condition.

	Year 1	Year 2	Year 3	Total P&L Charge
Total to be charged over period (5,000 x \$12)	\$60,000	\$60,000	\$60,000	
"Trued up" for forfeitures	\$51,000	\$52,800	\$54,000	
Multiplied by portion of vesting period expired	1/3	2/3	3/3	
Amount to be expensed up to this year	\$17,000	\$35,200	\$54,000	
Minus what has already been charged	\$0	\$17,000	\$35,200	
Amount expensed in year	\$17,000	\$18,200	\$18,800	\$54,000

AASB 2 Scenario 2: 0% of award vest as the market based condition is not achieved.

	Year 1	Year 2	Year 3	Total P&L Charge
Total to be charged over period (5,000 x \$12)	\$60,000	\$60,000	\$60,000	
"Trued up" for forfeitures	\$51,000	\$52,800	\$54,000	
Multiplied by portion of vesting period expired	1/3	2/3	3/3	
Amount to be expensed up to this year	\$17,000	\$35,200	\$54,000	
Minus what has already been charged	\$0	\$17,000	\$35,200	
Amount expensed in year	\$17,000	\$18,200	\$18,800	\$54,000

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