Gregory D. Hodgkiss
IFRS Implementation Manager
Group Accounting and Reporting

BP p.l.c.
Britannic House
1 Finsbury Circus
London EC2M 7BA
United Kingdom

CL 145

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International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

Direct 020 7496 2231
Main 020 7496 4000
Fax 020 7496 4547
Mobile 07733 455191
Hodgkigd@bp.com
www.bp.com

Dear Sir or Madam

ED2 SHARE-BASED PAYMENT

We are pleased to have the opportunity to comment on ED2. Responses to the specific questions posed in the ED are given in the Attachment below.

BP is an international group whose shares are listed in the UK on the London Stock Exchange and on US exchanges, in addition to various other exchanges throughout the world. Our financial statements are currently drawn up under UK GAAP and reconciled to US GAAP for our US filings. BP is supportive of the adoption of IFRS and the global harmonisation of accounting standards, and in particular we are keen to see the convergence projects of the IASB and FASB come to fruition. We expect that the result of this process will be a 'level playing-field' beneficial to investors and others.

We agree with the principle of recognising the fair value of share-based payments in financial statements but urge the IASB to ensure that this accounting principle does not become mandatory under IFRS while remaining voluntary under US GAAP. Only simultaneous adoption of a mandatory accounting standard by both the IASB and FASB will result in a level playing-field. The elimination of detailed differences between the two standards is a necessary pre-requisite for this. We believe that this topic presents a great opportunity for convergence to be achieved without a great deal of effort, as the differences between the two standards are not enormous, and the achievement of convergence would send a welcome signal to the business community.

Once the recognition of share-based payments in financial statements becomes mandatory, the level of disclosure required by the ED will be excessive. We believe such detailed and extensive disclosure should not be required for items which are recognised in financial statements. In our view, extensive disclosure is required only when items which are not recognised could have a potentially material and volatile impact upon the results of the entity. Items which are accounted for in accordance with a standard require only brief disclosure. In this instance we believe disclosure should be restricted to the charge for the year, a brief general description of the nature of the schemes, a summary of changes in the number of equity instruments during the period and a brief description of the type of model used to value the share-based payments.

As a possible alternative approach, it may be appropriate to determine the extent of disclosure according to the materiality of the share-based payment expense in the context of the entities' results. The more material the share-based charge, the more detailed the disclosure required.

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Registered Office: 1 St James's Square
London SW1Y 4PD

In accordance with the aim of developing principles-based standards, we believe that entities should be allowed to develop a valuation methodology for determining the cost of granting share options to employees in the way that the entities believe is most appropriate to their particular circumstances. Entities should be allowed to adopt simplified models or to change the model employed as modelling techniques evolve. However, we agree that any model developed should take into account, at a minimum, those factors specified in Q11 below. What is important, in our opinion, is that the method used should give consistent, unbiased results over time and should not be unduly onerous to use.

Finally, we believe it appropriate that any final standard should permit early adoption.

Yours faithfully

G D HODGKISS

ATTACHMENT

Our responses to the specific questions are as follows:

Q1. **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?

A1. We agree with the proposed scope.

Q2. **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?

A2. Yes, these recognition requirements are appropriate.

Q3. **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?

A3. Yes, this is appropriate.

Q4. **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?

A4. No, we believe that the appropriate measurement date in the case of goods or services other than employee services is the date that a binding contract for the goods or services is entered into. This is the date on which both parties to the transaction have agreed the value (the purchase or acquisition amount in a cash transaction), and is the equivalent of the grant date for employee share options. Recognition of the fair value of goods or services received should then be made as the equity obtains the goods or receives the services.

Q5. **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?

A5. Yes, this is the appropriate date.

Q6. **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?

A6. Yes, we agree with this approach.

Q7. **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?

A7. Yes, we agree.

Q8. **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?

A8. Yes, we agree with this presumption.

Q9. **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?

A9. Yes, we agree that it is necessary to determine the amount of fair value to attribute to each unit of service used. However, we prefer the approach used in SFAS 123, which does not adjust the fair value at grant date for the possibility of forfeiture. The adjustment of fair value to take into account expected forfeiture means that an assumption which may later turn out to be incorrect is set firmly in the fair value of services rendered. This seems illogical, particularly as the number of units of service rendered is corrected over the vesting period in accordance with the actual service received. In addition, the number of expected forfeitures may not have been a factor in the entity's decision about the granting of share options to employees and therefore cannot be considered to be a factor in the presumed 'fairly bargained contract' at grant date. Recognition of the value of services rendered should be based on the number of employees actually present during each accounting period. This approach seems simpler to apply, particularly for entities with little experience of such schemes, and does not have to be inevitably linked to accounting based on the number of instruments finally vesting.

Q10. 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?

A10. Yes, to the extent any final standard does not require forfeitures to be considered in measuring cumulative compensation expense, we agree.

Q11. 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?

A11. Yes, we agree.

Q12. 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?

A12. We agree with this approach.

Q13. 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?

A13. Yes, we agree that the vesting conditions must be taken into account. However, we do not believe that the fair value should be adjusted for the possibility of forfeiture. See A9 above.

Q14. 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?

A14. Yes, we agree.

Q15. 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?

A15. We have no additional suggestions for features of employee share option schemes for which the IFRS should specify requirements.

Q16. 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?

A16. We agree with this approach. However, it appears to us that the detailed requirements of paragraph 15 *are* prescriptive and should be moderated to allow the simpler FASB approach as discussed in A9. above. Appendix B would then become guidance.

Q17. **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, i.e. 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?

A17. We agree that incremental value granted should be taken into account when measuring services received. We prefer the first method, which treats repricing as a new option grant, as we believe this will be simpler to apply in practice.

Q18. **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.

A18. We do not agree that the entity should continue to recognise the services rendered by the employee as if the grant had not been cancelled. It does not seem logical on the one hand to cancel options because they are seen to be no longer efficient while on the other hand continuing to recognise the cost of the scheme even though it is unlikely that the services are still being rendered as expected.

In our opinion accounting for the original options should stop when the scheme is cancelled, unless some compensating arrangement is put in place. Where grants are cancelled during the vesting period but replaced by new options we believe that this should be treated as a modification of the original award, as in A17.

Q19. **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.

A19. Yes, we agree.

Q20. **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.

A20. Yes, we agree.

Q21. **The draft IFRS proposes that an entity should disclose information to enable users of financial statements to understand: the nature and extent of share-based payment arrangements that existed during the period, 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 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)?

A21. We believe that the disclosure requirements are excessive, particularly in the context of share-based payments which are recognised in the entity's financial statements.

Large international groups, such as BP, can have a large number of share-based payment plans in force, with different specific features adapted to different business sectors and regulatory frameworks. The disclosures required by paragraph 46(a) of the ED should be mitigated to a requirement to describe the general terms and nature of the plans with suggestions as to the type of information which should be considered by the entity in drafting the disclosure.

We agree that the information required by paragraphs 46(b), (c) and (d) (number and weighted average exercise price for movements in options during period and at period end, and range of expected price and expected life) are useful, in our opinion.

The detailed requirements of the description of the fair value model used, as listed in paragraph 48, are also excessive. Description of the model should be limited to the generic, such as 'a Black-Scholes option-pricing model' or 'a binominal option-pricing model'. Disclosure of the principal assumptions used in the model for the various variables should not exceed statements of the risk-free discount rates, the dividend rates, the expected lives of the options and the volatilities. As stated above, the detail required by the ED in this area should be provided as suggestions of factors to be taken into consideration by the entity in carrying out its modelling rather than as disclosure requirements to allow the user to 'audit' the computation made by the entity.

However, if the impact of recognising share-based payments is very material to the entity, disclosure as detailed as those proposed by the ED may be appropriate.

Q22. **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.

A22. We do not believe that the date of publication of an ED should be a relevant date for any accounting treatment. The use of the publication date of the ED implies that there is a suspicion that entities will somehow react in an improper fashion as a result of the publication. Furthermore, this implies that the IASB has already made up its mind about the standard and is not seriously seeking comment. We do not believe that such implied mistrust is helpful to the standard-setting process. The IFRS should state the date of application and the method of application (i.e. prospective of retrospective) by reference to the mandatory application date. Retrospective application should be permitted.

Q23. **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?

A23. We agree that these requirements are appropriate.

Q 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.

A24. We prefer the SFAS 123 approach as described in (b) and (c) above, on the grounds of practicality and, in the case of the second point under (b) and (c), as this approach appears to us to reflect more closely the reality of the impact of the decisions made.

Q25. **Do you have any other comments on the Exposure Draft?**

A25. We would like to emphasise the importance of convergence between IFRS and US GAAP both in terms of the requirements of the accounting standards and in the timing of mandatory adoption. Given that at present neither accounting regime has an accounting standard that mandates the use of one methodology for the recognition of share-based payments, this is an ideal subject for harmonisation. We encourage the IASB to continue working closely with the FASB to achieve this.