CL 190

NESTLÉ S.A.

DR. WOLFGANG H. REICHENBERGER
EXECUTIVE VICE PRESIDENT

INTERNATIONAL ACCOUNTING STANDARDS BOARD
30 Cannon Street

GB-LONDON EC4M 6XH

7 March 2003

EXPOSURE DRAFT ED 2 SHARE-BASED PAYMENT

Ladies and Gentlemen,

Please find below our answer to your invitation to comment on the above mentioned exposure draft.

CONVERGENCE WITH US GAAP

In our letter of 14th December 2001 in response to the invitation to comment on the G4+1 position paper on Accounting for Share-Based Payment, we mentioned that "it would be entirely unacceptable, on competitive grounds, for this approach [i.e. the expensing of share based payments] to be included in IFRSs when the same does not apply to US GAAP". Though there have been some positive signs in the U.S., namely that many U.S. companies now voluntarily expense their share based payments and that the FASB has mentioned in the summary of FAS 148 that it "plans to consider whether it should propose changes to U.S. standards on accounting for stock-based compensation", our comments made more than one year ago are still valid. We consider that ED2 is only going to be acceptable if the FASB adopts a similar approach simultaneously and we urge the Board to give a first priority to share-based payments in its convergence work with the FASB. Therefore our comments in this letter are conditional upon the success of the previously mentioned objective and we recommend that the effective date of the future IFRS on share based payments be concomitant with that of a similar U.S. GAAP standard. This convergence issue is of utmost importance not only for the comparison between IFRS and US GAAP companies but also for IFRS companies which either have US listed subsidiaries or which are themselves listed in the US.

AVENUE NESTLÉ 55 CH-1800 VEVEY (SWITZERLAND) TELEPHONE (021) 924 21 11 TELEFAX (021) 921 18 85

REOUIREMENTS OF THE ED

Apart from our areas of concern outlined below, we generally agree with the ED and, in particular, with the requirement that share-based payments represent an expense but we recommend that the framework be modified in order to allow a strong conceptual justification for the expensing of share-based payments because, in its current state, the Framework says that an expense results from the depletion of an asset or the incurrence of a liability. Therefore, as long as the Framework is not clarified, there will always be arguments against the expensing of share-based payments which result in the incurrence of equity.

As far as the requirements of the standard are concerned, we consider that measuring equity-settled transactions with employees at the fair value of an equity instrument determined with an option pricing model is a matter of convention which we can live with subject to the conceptual justification mentioned above. Nevertheless we encourage the Board to carry out further research to improve the feasibility of the valuation models, which in their current state cannot always be deemed as reliable since the valuation is a matter of specialists whose advices may diverge.

On the positive side, we welcome the principle based approach of the ED and, in particular, the valuation at grant date with an anticipation of the turnover rate of the participants and no subsequent adjustments to equity even if the instrument does not vest or if options are not exercised. These requirements are a prerequisite to enable the preparers to determine the charge without complicated adjustments for the forfeiture of options.

AREAS OF CONCERN

In addition to detailed points that are explained in the attachment, our main areas of concern are disclosure requirements and the accounting treatment for acquisition of shares at the inception of share option plans for the exercise of the options.

Disclosures

While we agree that the users should be informed about the specificities of the share-based payment plans, we consider that the disclosures are diverted from their original aim when they require information whose only purpose is to verify the calculations made by the preparers as it is the case in most of the requirements of § 48. The verification is the role of the auditors and the disclosures should not be loaded with such type of information. We also consider that the disclosures should not contain any comparisons with theoretical situations such as that of § 52 (b) which requires to disclose the difference between the cost of a cash settled transaction and of an equity settled transaction.

Shares acquired at inception of a plan for the exercise of options

We recommend that the Board addresses the issue of companies, which, at inception of option plans, either buy shares on the financial markets or earmark treasury shares in anticipation of the exercise of their option plans. While we agree that such companies should recognise the cost of their options, we recommend that the fact that they have hedged their exposure against the future changes of their share price be recognised and disclosed in the income statement as a credit against their share based payment charge. In effect, such companies already incur a financial cost for holding their own shares and charging an expense to them would result in double counting.

The attached annexe answers the specific questions which have been asked in the invitation to comment. Should you want to discuss some of the issues that we have raised please feel free to contact Mr. H. Wirz, Senior Vice-President, Head of our Group Accounting and Reporting department.

We thank you for your attention to the above and for allowing us the opportunity to comment on this exposure draft.

Sincerely yours,

NESTLE S.A.

Dr. W. Reichenberger

ED 2— SHARE BASED PAYMENTS

ANSWERS TO SPECIFIC QUESTIONS AND OTHER COMMENTS

Question 1— Scope

We agree with the scope.

Question 2— Recognition

We agree in principle but we consider that, instead of taking a justification in another set of standards (US GAAP), the Board should consider changing the Framework so that it includes a clear and sound conceptual justification for share based payments because, otherwise there would always remain arguments that share-based payments do not represent an expense.

Question 3- Measurement directly at the fair value of the goods or service rendered or indirectly by reference to the fair value of the equity instruments granted which ever is more readily determinable

We agree.

Question 4— Measurement at the date the entity receives goods and services when a share- based payment is measured directly.

We agree because this requirement is in accordance with the current practice of not recognising firm commitments until they are performed.

Question 5— Measurement at grant date when a share-based payment transaction is measured by reference to the fair value of the equity instruments granted

We agree and consider that the grant date reflects the economic substance of the transactions, i.e., the value that the enterprise would have received had it placed the instruments on the financial markets to raise cash.

Question 6— Equity settled transactions with transactions with parties other than the employees

We agree that there is a rebuttable presumption that the fair value of the goods or services is more readily determinable.

Question 7— Equity sealed transaction with employees

We agree but we believe that designating the fair value of an equity instrument as a surrogate measure for services is a matter of convention. However as we admit that share-based payments represent an expense, we can live with that convention.

Question 8— Presumption that the services are rendered during the vesting period

We agree. However if only part of the instrument granted refers to past services, paragraph 13 should be applied to this part (immediate recognition at grant date) and, if another part of the instruments refers to future services, then paragraph 14 should be applied to this other part (recognition in future over the vesting period).

Question 9— Attribution by units of services rendered

We agree with this method.

Question 10— No subsequent adjustment to equity

We totally agree with the requirement that an entity should make no subsequent adjustment to equity even if the equity instrument does not vest or if options are not exercised. We consider that this clause is very important because it enables the preparers to determine the annual charge in a simple manner without complicated adjustments for the forfeiture of options (please also see under question 13).

Question 11—Option pricing models

We agree. However, as pointed out under our answer to question 7, the use of fair value of an equity instrument as a surrogate measure is a matter of convention. Nevertheless we encourage the Board to continue carrying research on how to improve such models.

Question 12— Non-transferability and vesting conditions

We agree that replacing the contractual life of a non-transferable option by its expected life is the appropriate mean of taking into account of the non-transferability of the option. We also consider that this requirement is appropriate for taking into account the inability to exercise during a given period.

Question 13— Grant of shares conditional upon satisfying vesting conditions

We fully support the requirement of § 24 that states that vesting conditions should be incorporated into the option pricing model or by making an appropriate adjustment to such model. We believe that this requirement is the only way to avoid complicated reversal of charges in case of option forfeiture.

Question 14— Reload features

We agree with § 25 and especially with the last sentence that says that if the reload feature is not taken into account in the fair value measurement, then the reload option should be treated as a new grant. This is justified by the fact that at grant date an entity cannot presume that the reload feature would be exercised and have difficulties in measuring that feature anyway.

Question 15—Specific requirements for employee stock options

We consider such requirements as adequate. However the Board should include additional guidance about plans whose shares vest immediately upon payment but for which the participant has to wait during a certain blocked period until he or she can re-sell the shares; however, if the participant leaves, then he or she can immediately dispose of the shares.

Question 16— No prescriptive guidance

We absolutely agree with this approach which is, as mentioned in this question, in accordance with principle based standards. Nevertheless we recommend that illustrative numerical examples be added to cover the most common forms of share based payments such as, e.g., grant of shares under an optional employee share plan, the grant of shares under a share purchased plan, adjustments for non-transferability of options that are normally traded in active markets and the treatment of blocked features as per question 15 above.

Question 17— Repricing of options

We agree that the incremental value granted upon repricing should be taken into consideration because, at inception, the enterprise did not assume that the option would be repriced.

Question 18— Cancellation of plans durin9 the vesting period (other than by forfeiture)

We consider that the following cases should be considered and explained.

First in the case where the non vested shares or options are replaced by a new option grant, the entity did not presume that the option would be replaced and this corresponds to a repricing as stated in question 17 (i.e. to continue to recognise a charge for the existing plan and to recognise an incremental charge for the repricing).

In contrast, if the enterprise settles the non-vested options with cash during the vesting period, we consider that the plan is terminated and we disagree to continue recognising a charge in the income statement because this would not represent the economics of the transaction. In such a case, the amount of the settlement should be deemed to be the cost for the period and no further amount should be recognised.

Finally if a company repurchases an equity interest, such a transaction should be treated as a decrease from equity up to the amount of the fair value of the shares that are repurchased and as a charge in the income statement for the excess.

Question 19— Cash settled share based payment transactions

We agree that an entity should remeasure the liability at each balance sheet date because that liability represents the fair value of the obligation under the plan at the balance sheet date.

Question 20— Compound share based payments

We agree but we recommend that the examples be enhanced with accounting entries because the proposed treatment is very complex.

Question 21— Disclosures

We agree with the principles of paragraphs 45, 47, 49, 50 and 51 but we consider that the following requirements are exaggerated:

- Paragraph 48 as a whole. The purpose of disclosures is to inform the users and not to enable them to check the information of the entities: this is role of the auditors. In particular the following information is exaggerated and would result in lengthy notes with little value added for groups of companies having several share-based payment plans:

    - historical volatility
    - determination of the risk-free rate
    - assumptions and explanations on vesting conditions
    - measurement of incremental value
    - comparisons
    - etc.

Therefore We recommend that § 48 be limited to a general description on:

- the option pricing model used (e.g. Black & Scholes, binomial, etc.)
- volatility used
- percentage of risk-free rate
- vesting conditions and turnover rate assumptions used in adjusting the option pricing model
- information about changes of share-based payments plans during the period.

- Letter (c) of § 46 : the weighted average share price at the date of exercise: this requirement should be deleted. We consider it is not necessary to enter into such details and that the requirement of § 46 (b) (iv), i.e. the number and weighted average exercise price for the year is sufficient.

- Letter (b) of § 52 : since the ED requires to remeasure the fair value of cash settled share-based payments at each balance sheet date until the liability is settled, we consider it is illogical to determine the difference with an equity settled plan. The accounts should reflect the reality of the transactions and not "as if situations.

Question 22— Transitional Provisions (and effective date)

We disagree with the, retroactive transitional provisions of the ED and, in particular with the provision which requires that the future IFRS shall apply to all the issues of equity instruments that were granted after the publication of the ED and that have not vested at the effective rate. We recommend that the future IFRS be applied prospectively for all share-based payments granted after the 1st January of the year following the publication of the IFRS in order to leave enough time to the preparers to apply the requirements on the basis of a final document.

As mentioned in the covering letter from our CEO, we also recommend that the effective date be postponed until the FASB issues a standard on share based payment similar to the future IFRS. If the future FASB standard contains substantive changes compared to the currently exposed future IFRS, then such IFRS should be re-exposed.

Question 23— Deferred Tax Consequences

While we agree that share-based payments indeed give rise to deferred taxes, we consider that this issue could cause undue cost and effort when a group of companies has a global plan that covers participants in several countries where the grant of the instruments may or may not be subject to taxation. We recommend that IAS 12 § 15 (b) (ii) that deals with transactions that affect neither accounting profit nor taxable profit be applicable to share based payments made in countries where such payments are not subject to taxation.

Question 24— Differences with US GAAP, FAS 123

We consider that the requirements of ED2 are superior than those of FAS 123 with the exception of letter (c) of this question. We recommend that, if an entity settles in cash a grant of equity instruments, these should be regarded as having immediately vested and the plan is terminated as requested under FAS 123. As stated under question 18, we disagree with the requirement to continue recognising an expense during the vesting period.

Question 25— Other Comments

Shares acquired at inception of a plan for the exercise of options

As stated in the covering letter from our CEO, we recommend that the Board addresses the issue of companies, which, at inception of option plans, either buy shares on the financial markets or earmark treasury shares for the exercise of their option plans. While we agree that such companies should recognise the cost of their options, we recommend that the fact that they have hedged their exposure against the future changes of their share price be recognised and disclosed in the income statement as a credit against their share based payment charge.

Examples in the Appendix

We recommend that the examples be completed with accounting entries.

Fair value of share-based payment arrangements with cash alternatives

We recommend that the example of the implementation guidance paragraphs IG40 to IG43 (pp. 12-14) be transferred to the appendix of the future IFRS because all the examples should be part of the standard.

Application within a consolidated group

The future IFRS should make it clear that it applies not only to share based payments of the parent but also to those of any members of a consolidated group. Should a subsidiary issue share-based payments, these should give rise to minority interest because the consolidated group is diluting its share in its subsidiary.