INTERNATIONAL ASSOCIATION OF FINANCIAL EXECUTIVES INSTITUTES

DCP/CRG/ED2-SHAREBASEDPAYMENTS

International Accounting Standards Board
30 Cannon Street
LONDON EC4M 6XH

12 March 2003

Dear Sir,

ED2: SHARE-BASED PAYMENTS

Set out below are our responses to the questions in the above draft IFRS. We note that it has become more widely accepted that share option costs should be charged as an expense, although some would argue for certain exemptions. On this basis we are in general agreement with ED2. However, we would make the following overall points:

- if such expenses are to be recognised, then all major standard setters (including the US) should move to convergence at the same time.
- we agree with a "principles" based approach rather than detailed requirements given that there is likely to be much debate over the valuation methods to be used.
- we believe that the extensive level of disclosure is totally out of proportion for this one standard.

Q1: While we are in broad agreement with the approach in ED2 we would suggest that further consideration is given to the following:

(a) Some countries have a public policy to allow companies to offer schemes to all employees (as opposed to incentive schemes for senior management which tend to be performance based). While it is a difficult argument to say that public policy should override correct accounting, there is a concern that the consequent costs of ED2 to calculate what for a number of companies could in any event be a small charge, will lead to the discouragement of such schemes.

(b) Given the difficulties unlisted companies will face in complying with ED2 and the associated costs, the methodology allowed should be relatively simple to ensure that any benefits outweigh the costs.

(c) For a Group, the company operating the scheme should reflect the appropriate charge and any recharging to other Group companies, which in turn will reflect the recharge as their expense. An exemption should be considered for subsidiaries in respect of the disclosures in ED2 as it is difficult to see what benefit there in splitting out the Group information at such a company level. In addition it should be noted that within the years covered by a specific grant, individuals will be transferring between different subsidiaries.

Q2: Agree.

Q3: Agree, subject to point (b) in Q1.

Q4: The measurement approach of using the date when the entity obtains the goods or receives the services seems inconsistent with the approach in Q5 i.e. should it not be the contract date?

Q5: Agree.

Q6: Agree.

Q7: It would be more consistent with Q6 if there was a rebuttable presumption rather than a requirement. If this change is not made, then the wording in paragraph 12 needs to be revisited e.g. the words “typically” and “usually” are not appropriate.

Q8: Agree. Even if the quantum of the grant of shares is calculated on the performance of the company and/or individual in the past, if the grant is only exercisable by say remaining in employment for a future period (i.e. “retention bonus”) it would be consistent with the ED to expense over that future period i.e. over the period that the relevant service is received by the company (B 193 in the Basis for Conclusions). This is also consistent with the substance of the transaction which is to obtain future performance by the employee for at least a specified period.

Q9: While one can see the theoretical appeal of the methodology of charging the expense over the service period as set out in ED2, it will be somewhat complicated to apply in practice. Given the subjective nature of the initial calculation of the fair value, would it not be simpler and acceptable to just amortise the initial fair value on a straight line basis. While this would not allow for actual lapse experience deviating from that expected at the outset, to adjust for such changes seems inconsistent with the approach in ED2 of not truing up for any other changes past the grant date e.g. if the grant does not vest wholly or partly because of a failure to meet performance criteria.

Q10: It seems odd not to adjust for these sort of changes as, for example, if an option lapses an entity will have expensed an expected cost so if this final cost is zero why would they not have an offsetting gain to reverse the earlier cost? However, once it is suggested that the provision should be trued up for subsequent changes, it seems we are moving towards a vesting date basis which was rejected in the responses to the previous discussion paper. On that basis we agree with the approach in ED2.

Q11: Agree (see also Q16).

Q12 Agree.

Q13 Agree.

Q14: Agree with the options allowed for in paragraph 25 as in practice valuing such reloads as a new grant is likely to be used at least in the short term.

Q15: At this stage of developing models to apply ED2 we agree with the guidance on likely factors as set out but leaving open the possibility of additional factors being relevant.

Q16: Agree for the reasons set out in the Basis for Conclusions. Until there is more practical experience across a range of countries in developing and using models for valuing the options covered by ED2, it would be premature to mandate a particular approach and set out prescriptive detailed requirements.

Q17: Agree that the incremental value granted should be taken into account. Our preference is for the alternative approach as this reflects the substance that a repricing has occurred rather than continuing to run off the original option (which no longer exists) separately.

Q18: Disagree. On the basis of the general approach in ED2 we fail to understand the logic in BC220 of the Basis for Conclusions. If an option is cancelled then it is difficult to see how it can still be regarded as giving rise to future services received by the company - future service units are zero. Moreover, as noted in ED2, there will often be a payment or new scheme to replace the cancelled scheme. If a cash payment is made then (at least to the value of the charge under ED2) this would need to be charged to equity if the unexpired portion of the grant continues to be expensed to income. If there is a new scheme this will be expensed to reflect the service received in the future. However, if the straight line expensing set out in Q9 was adopted, then logically any residual value would be expensed immediately.

Q19 Agree with suggested approach but we do not see the relevance of the disclosures in *52(b)* as noted in Q21 below.

Q20: Agree.

Q2l: We do not believe the quantum of disclosures is reasonable. One can always make arguments for specific disclosures but it is necessary to consider whether the total is reasonable and consistent with the level of other disclosures - -in this case we do not believe this is so and it will constitute a burden on preparers out of proportion to any benefit. For a multinational with a number of schemes, each with a number of separate grant dates, there would be a significant exercise to collate all the data for disclosure and an extensive note to the accounts. In particular we would suggest

- deletion of 46(c), 46(d) and 48(e) as unnecessary detail.
- 48(a)(i) should require an explanation of the model and principles involved rather than a whole series of detailed assumptions. It is also necessary to bear in mind that some assumptions may be commercially sensitive information. This would also knock on to the wording in 48(c) and 48(d). It is also relevant to the detail apparently required under paragraphs 48(a) (ii to (v) and 48(b).
- if it is clearly explained what a company is doing on equity .v. cash based schemes and applied, we do not see what useful information is provided by *5* 2(b). Having made the distinction between the two forms of share based payment transactions and established the logic for measurement etc, it seems an unnecessary burden to then require a further calculation of what the charge on cash based settlement would have been if measured as for equity based settlements. If the IASB believes the method applied to each scheme is right, then application of those as appropriate should be sufficient.

Q22: We believe that companies should have the option (but not the requirement) of full retrospective application. This would mean that, if they felt able to make the necessary calculations on a reasonable basis, they could reflect an appropriate trend in their results. In any event those companies which felt unable to calculate the effect, would presumably explain any distortion. In the introduction of a standard such as this we feel such flexibility in not unreasonable.

Q23: The example which is to be added to IAS12 proposes that all the tax effects of share-based payments should, be recognised in the income statement but this appears contrary to the logic in ED2. The proposals in ED2 make a firm split between expense to be recognised in the income statement and the effect of vesting which is an equity transaction. This would suggest that the expense should be tax effected and any difference between that tax and the tax impact of vesting is an equity effect.

Q24: Agree with the approach taken by ED2 subject to the following points:

- For the reasons noted above, we would prefer to include the exemptions in the first and third points under (a) in the question.
- As regards point (c) in the question, it is difficult to see the logic of expensing in future periods for service received in respect of an option which no longer exists. We therefore believe an approach in line with the SFAS 123 principle is more appropriate, perhaps expensing immediately based on expected service to the original expected exercise date. However, we would also refer to our comments on Q18. As regards BC221 of the Basis for Conclusions, we believe there is a difference between settling in cash or with a new option - in the latter case there is a reward for future service whereas in the former there is not.
- As regards point (f) see Q23 above.

Q25:

- If we are to have a standard which expenses share option schemes then it is important that all standard setters follow the same approach and at the same time, especially the US. This could change the effective date for the implementation of the IFRS from 1 January 2004.

- We continue to believe that there should be a specific materiality clause as in prior IAS and are concerned over the IASB moves away from this.

- As regards BC16 to B19 it does not seem appropriate, where a subsidiary has received the relevant parent company shares for nil consideration, to include an expense in the subsidiary accounts but not recognise an offsetting gain as there is no net cost for the subsidiary.

- Given the national requirements on share capital, share premium, other reserves etc. we can understand why ED2 does not address these in detail and it is better left to national standard setters to fill in the gaps.

Yours faithfully,

D C POTTER
Chairman, C.I.A.S.