Comment letter from Debenhams Plc

April 22, 2003

Paul Ebling
Accounting Standards Board
Holborn Hall
100 Gray's Inn Road
LONDON
WC1X 8AL

Dear Mr Ebling

FRED 31 SHARE BASED PAYMENT – REPRESENTATION FROM DEBENHAMS PLC

I am enclosing Debenhams response to the exposure draft FRED 31 Share Based Payment.

Accounting for share based payment is an important issue for Debenhams as we have extensive share option plans and over 23,000 employees. We have completed a preliminary assessment of the impact of FRED 31 on Debenhams and have a number of concerns as detailed below.

Opposition to the recognition of share based payments in the financial statements

We welcome any development that provides all users of accounts with clear and understandable information on share based payments as well as a reliable estimate of the associated cost, yet does not undermine the encouragement of employee share ownership and impose unreasonable compliance costs.

Shareholders are demanding this information and there is public pressure for greater transparency on share based payments. However we believe that the exposure draft fails to adequately address these issues. We highlight the following;

1. The profit and loss charge based on an option-pricing model does not represent either the ultimate cash cost to the company or the impact of dilution on existing shareholders. The charge is of course based on the estimated fair value of the services received. As such the profit and loss account expense is fictional, bearing no relationship to the cost to shareholders through dilution, the ultimate cash cost (if any) to the company, or the gains made by those receiving share based payments. Additionally there is the (debatable) point that these proposals will impact EPS twice. Firstly when shares are issued and secondly when the expense is recorded.

   In issuing this exposure draft the IASB/ASB has successfully demonstrated the severe practical and theoretical difficulties in calculating a sensible profit and loss charge. We do not believe these practical and theoretical problems have been satisfactorily resolved, until they are we do not support the implementation of FRED 31.

2. Some sophisticated accounts users may want share-based payments to be expensed through the profit and loss account. However there are a myriad of other users, and the IASB/ASB cannot expect the average informed user to understand the accounting complexities and not be misled into thinking that the charge is ultimately a realisable cost of the company.

   As stated in the IASB's framework the purpose of financial statements is to provide information about the financial position, performance and changes in financial position of an enterprise that is useful to a wide range of users. In our opinion this standard contradicts this and the ASB's statement of principles by placing too much emphasis on the needs of sophisticated professional users to the detriment of others.

A key qualitative characteristic of financial statements is the 'understandability' of the information provided. We believe that understanding required to assess the impact of share option accounting under FRED 31 is above the expected capabilities of users as set out in the ASB's statement of principals and the IASB's framework.

3. The estimated charge is difficult to estimate and is extremely sensitive to changes in the underlying assumptions. Using different option-pricing models – of varying sophistication - can also produce markedly different results. Any charge is a broad estimate and essentially unreliable. Given this one questions its use for cross company comparisons. Our expectation is that analysts will ignore any charge when comparing us to our peers.

4. These proposals are complicated and will be difficult to implement. We envisage that we can undertake a lot of this work in house, however the drain on management and staff time should not be underestimated. This standard may also necessitate external professional advice. These additional costs are a direct consequence of this standard and the IASB/ASB should be mindful of this additional burden on business.

5. Evidence suggests that all employee share schemes enhance company performance. If adopting this exposure draft these are now deemed to be too costly and stopped we may see a fall in productivity.

We are opposed to the expensing of share based payments. The current proposals would be costly to implement, would produce unreliable answers which would be ignored by analysts, and would not make the operation and cost of share option schemes more transparent to users.

We believe the focus of the IASB's and ASB's work should be on enhancing the disclosures made with respect to share based payments. This would be more useful to users than an unreliable profit and loss charge based on complicated theoretical calculations.

Additional comments

We have made clear above our opposition to the expensing of share based payments into the profit and loss account. However if this approach to option accounting is adopted we have a number of matters we would like to draw to your attention.

Exemption for all employee share schemes

The following should be considered as an answer to ASB question 3 and IASB questions 1 and 2

a) Public policy considerations

Of most concern to us is the proposal that there is no exemption for share save schemes in FRED 31. The fact that these schemes will now entail a large charge to the profit and loss account will be a significant additional factor to consider when we assess whether or not to continue offering a share save plan.

Initial surveys show that a significant number of companies will significantly change their all employee share schemes as a result of these proposals, executive schemes however will remain largely unchanged. Given that the vast majority of the bad press on share options centres on executive schemes it is ironic that this proposal is likely to restrict all employee schemes. Our view is that concerns over executive share schemes are best addressed by better corporate governance procedures.

Share save schemes serve to increase motivation, commitment, and to align the interests of employees with those of the company and its shareholders. Recent evidence shows that implementation of company wide share schemes enhances company performance. The abandonment of schemes, as a consequence of introducing FRED 31, is a high price to pay in order to get the accounting correct.

We believe the ASB/IASB should consider these factors in deciding the appropriate accounting treatment, and exempt all employee share schemes from the scope of the standard.

b) Services received

In addition to the public policy grounds there are sound accounting reasons for including an exemption for all employee share schemes.

FRED 31 assumes that shares or options are issued in exchange for services. In reality we believe the position is less clear.

It is true that executive share schemes are mainly given as a form of remuneration, however all employee plans are often given to increase commitment, motivation, and to align the interests of employees with those of the company and its shareholders. Evidence shows that companies consider these the reasons for implementing all employee share schemes, rather than as a method of remunerating employees. Typically such plans are outside the scope of employee pay negotiations.

This shows that shares or options are not just given as compensation of services received. The draft standard does not reflect this complexity.

On this basis we believe that exemptions should be made available for certain all employee share incentive schemes, particularly for share-save schemes.

Estimation of the fair value of options

This section should be considered as an answer to IASB questions 11 and 16.

FRED 31 sets out in detail how the charge to the profit and loss account should be calculated for share option schemes. There is no specific guidance on the basis for estimating the fair value of options granted.

Although paragraph 20 indicates factors that should be taken into consideration, it does not specify which option-pricing model should be used. Although this is consistent with the IASB's objective of setting principles based standards it means that a wide variety of results are possible. For example the adoption of a different option-pricing model can produce a markedly different answer. A wide variety of interpretations would undermine comparability.

We believe that in practice the Black Scholes model will be used by the majority of companies, despite serious concerns over its suitability for valuing employee share options. The IASB/ASB should consider mandating the use of an alternative and more appropriate options pricing model.

Overall we suggest that more detailed guidance be given in the standard on how any expense is calculated. An alternative approach would be to have a long implementation period with disclosures only, this would allow time for best practice to develop.

International Convergence

The U.S.A. and the U.K. are the principal countries impacted by this standard due to the extensive use of share option plans. We support the need for an internationally agreed approach, however our concern is that this will not happen.

We believe that FRED 31 should not be introduced until all major countries, particularly the U.S.A., have agreed to implement its international equivalent. As a minimum implementation should be delayed to correspond with the UK adoption of International Accounting Standards in 2005.

Transitional Provisions

These comments should be considered a response to ASB question 6 and IASB question 22.

Given that many UK share schemes have a life of 7-10 years the transitional arrangements contained in paragraph 54 will result in dual accounting. Options granted before November 2002 will be accounted for under a different set of rules to those granted since.

This could seriously undermine the validity of any profit and loss charge. Users of the accounts would not be able to see the full FRED 31 cost for a number of years. Consequently comparing with other companies would not be on a like for like basis. For example companies that adopt a policy of large one off grants every few years, and granted options just before November 2002, will be at an advantage over others who adopt a smother pattern of grants each year.

This means that companies may not be on a comparable basis for a number of years after the standard has been introduced. This issue appears not to have been addressed by the IASB/ASB. We question the validity of including any charge while this dual accounting issue exists.

Unless the standard is applied retrospectively, which would be difficult, this is not easy to resolve. We suggest that there be an extended transitional period during which any charge is disclosed in the notes, in a manner similar to the adoption of FRS 17 Retirement Benefits. This approach would largely resolve the issues of comparability and dual accounting outlined above.

Sincerely,

Ashley Cartman
Technical Reporting Manager
Debenhams Plc