LIBA

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7 March 2003

Kimberley Crook
Project Manager
International Accounting Standards Board
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By email to: CommentLetters@iasb.org.uk

Dear Ms Crook

Exposure Draft ED 2 Share-based Payment

I am writing on behalf of LIBA (the London Investment Banking Association) to comment on the above Exposure Draft. LIBA is, as you know, the principal UK trade association for investment banks and securities houses; a full list of our members is attached.

Particularly in the current environment, we are generally supportive of the principle of recognising share-based payments, but we do have a number of specific comments on certain aspects of the Exposure Draft. The comments below follow the structure of the questions set out in the "Invitation to Comment" section of the Exposure Draft. Please note that we have not responded to all of the questions.

Question 1

Paragraphs 1-3 of the draft IFRS set out the proposed scope of the IFRS. There are no proposed exemptions, apart from for transactions within the scope of another IFRS.

Is the proposed scope appropriate? If not, which transactions should be excluded and why?

We refer specifically to Paragraph 2 of the Exposure Draft which provides that transfers of equity instruments of the entity's parent, or another entity in the same group as the entity, to the entity's employees are share-based payment transactions.

Where a parent entity issues shares or options to the employees of a subsidiary in return for services received by the subsidiary, it is usual for the parent to charge its subsidiary for the expense of the share issuance and record the amount as an inter-company management recharge. It can also be the case that the parent entity is outside the jurisdiction of IAS (eg listed in the US). When we apply this factual situation to ED2 certain conceptual and practical concerns arise.

ED2 does not provide clear guidance on how such a transaction would be treated in the accounts of the subsidiary. If the transaction is treated as an equity-settled share-based payment, then the subsidiary would be required to reclassify the inter-company payable with its parent, into equity. We consider that this result would be misleading because it would not reflect the true nature of the transaction. It would falsely inflate the capital base of an entity and could give the incorrect impression that the subsidiary itself had issued shares or options. Consequently, we consider that it would be more appropriate to consider such transactions as a cash-settled share-based payment in the accounts of the subsidiary, retaining an inter-company payable to the parent or other relevant entity with no entries made to equity in the subsidiary.

We also believe that the measurement basis for this liability should follow the actual liability that the subsidiary entity has, particularly where the management recharge itself has been determined by reference to the fair value of the arrangement. Appropriate disclosure could then be given in the accounts to ensure that a user understood the nature of the arrangement being reflected. This is particularly relevant for those entities where the parent entity follows a GAAP other than IAS and the basis for valuation of share-based payments is different to that proposed in ED2, such as the basis followed in the US.

If the liability under IAS is valued on a different valuation basis to the actual liability the subsidiary has, this would result in a reversal of any amounts taken at the time the actual liability is settled. We understand the principles underlying ED2 that require an entity to reflect the fair value of goods or services received as part of a share-based payment transaction, but we also consider that there are good conceptual arguments as to why a liability should reflect the contractual amount owed (or accrual for such a liability). The conflict between these conceptual approaches will be highlighted when the liability is settled in cash. Should the IASB insist on requiring a subsidiary to record a liability at an amount that does not reflect what is owed, then we strongly suggest it provides further guidance on how to treat the resulting difference that will arise on settlement. We also draw your attention to our comments under Question 10 below.

Question 10

In an equity share-based 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…(paragraph 16). However, this requirement does not preclude the entity from recognising a transfer within equity…

Do you agree with this proposed requirement?

As noted in our response to Question 24 below, we disagree with the proposed treatment of forfeitures whereby the expense recognised for equity instruments that are ultimately forfeited is not reversed. We view the initial and subsequent assessment of likely forfeitures as a subjective estimate, which should be adjusted similarly to other subjective balances within the financial statements. As such, we do not agree that an entity should make no subsequent adjustment to total equity.

However, whether forfeitures are adjusted for or not, we are concerned that the ED does not provide sufficient guidance on the treatment of balances in respect of share based payments once they have been initially recognised within equity. Such clarity is necessary to ensure comparability and transparency between the accounts of different companies.

Paragraph 16 states that an entity is not precluded from "recognising a transfer within equity", in the context of a share based payment transaction, while paragraph 72 (b) of the ED of revised IAS 1 Proposed Improvements states that "an entity shall disclose …a description of the nature and purpose or each reserve within equity". It is not clear how the requirements of ED 2 and the proposed revised IAS 1 interrelate, nor is it clear how best to describe the equity balances that could result from the application of ED 2. We appreciate that there are limitations in certain jurisdictions as to how balances within equity should be presented. However, we do believe that more could be done with the proposed IFRS to provide minimum requirements within the potential legal constraints.

If the Board does not accept our recommendation that forfeitures should be adjusted for, we believe it would be more informative to split out from the reserve, amounts relating to contracts which have expired or been forfeited. We also believe it would be helpful for the Board to be explicit regarding the subsequent entries to be made to the reserve amount once options are exercised.

Question 11

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 the options granted, by applying an option pricing model that takes into account various factors, namely the exercise price of the option…

Do you agree that an option pricing model should be applied to estimate the fair value of the options granted? If not…

We are supportive of the use of option pricing models to estimate the fair value of the options granted and we believe it is appropriate to be given flexibility in the choice of pricing model to be used. In particular, as more refined techniques and models evolve, which allow issuers to better capture the economics of an employee stock option, such improved methodologies could then be incorporated in the valuation techniques.

Question 21

The draft IFRS proposes that an entity should disclose information to enable users of financial statements to understand:

(a) the nature and extent of share based payment arrangements that existed during the period,

(b) how the fair value of the goods and services received, or the fair value of the equity instruments granted, during the period was determined, and

(c) 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]?

We believe it is appropriate to disclose information about the nature and extent of share-based payment arrangements, including activity in such arrangements during the reporting period. Information relating to the assumptions used in the model valuations should be helpful for users to assess the appropriateness of the amounts recognised and are important given the flexibility in adjusting the option valuation model. However, we believe it is also important to maintain an appropriate balance for all disclosure, ensuring that the quantity of any disclosure is not so extensive that it undermines the quality of the financial statements.

Question 22

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 but had not vested at the effective date of the IFRS. It also proposes that an entity should apply retrospectively the requirements of the IFRS [with certain exceptions].

Are the proposed requirements appropriate? If not, please provide details of your suggestions for the IFRS's transitional provisions.

Given the nature of the proposals in the Exposure Draft, we believe it is appropriate to apply the requirements on a prospective basis for the granting of equity instruments. However, we believe that this should be from the date of the publication of the final standard, rather than the Exposure Draft, which could still be subject to significant change.

Notwithstanding our comment below in Question 24, we also believe that sufficient time should be given for implementation, as the majority of companies who currently issue share options do not otherwise trade in options and will not have easy access to option pricing models and the related expertise.

Question 24

– Convergence with US GAAP

For such an important and relatively new requirement, we believe it is essential that the accounting for share-based payments should be consistent globally. We would therefore urge the IASB to consider as a matter of urgency adding accounting for share-based payments to its short-term convergence project with the FASB, if necessary delaying the issuance of a final standard to ensure such convergence. Based on the current proposals, a number of our members will need to maintain at least two separate sets of calculations to determine the amounts for share-based payment transactions and we do not support the development of such significant GAAP differences in this area.

There are two key areas where we believe, at a minimum, the IASB should reconsider its approach and follow more closely the approach taken by US GAAP. Firstly, we believe that the units of service approach taken by the IASB is unduly complex and that consequently, the calculations will be burdensome.

Secondly, the inability in the Exposure Draft to subsequently amend estimates made at the time of grant for forfeitures and similar changes is inconsistent with the accounting for other subjective balances in the financial statements. Estimates have always been an inherent part of the financial statements, particularly when calculating other employee related amounts, such as pensions.

In addition, we draw attention to our comments on the impact of GAAP differences outlined in our response to Question 1 above.

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I hope that these comments are helpful. We would of course be very pleased to expand on any particular points if there are aspects which you find unclear, or where you would like further details of our views.

Yours faithfully

Ian Harrison

Ian Harrison
Director

LONDON INVESTMENT BANKING ASSOCIATION

LIST OF MEMBERS

ABN AMRO Bank N.V.
Arbuthnot Latham & Co., Limited
BNP Paribas
Bank Insinger de Beaufort plc
Barclays Capital
Bear, Stearns International Limited
Beeson Gregory Limited
Cazenove & Co. Ltd
CIBC World Markets Plc
Citigroup Inc.
Close Brothers Corporate Finance Ltd
Collins Stewart Limited
Commerzbank AG
Credit Suisse First Boston (Europe) Ltd
Daiwa Securities SMBC Europe Limited
Dawnay, Day & Co., Limited
Deutsche Bank AG London
Dresdner Kleinwort Wasserstein
Goldman Sachs International
Greenhill & Co. International LLP
Hawkpoint Partners Limited
HSBC Investment Bank plc
Instinet Europe Ltd
Investec Bank (UK) Limited
J.P. Morgan Securities Ltd
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