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Ms Kimberley Crook
Project Manager
International Accounting Standards Board
30 Cannon Street
LONDON
EC4M 6XH

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Dear Ms Crook

ED 2 "SHARE BASED PAYMENT"

I am writing with BT Group's views on the IASB's Exposure Draft 2 "Share Based Payment" (ED 2).

We feel that there are arguments in both directions on the issue of whether share options satisfied by the issue of new shares should be reflected by an expense through the profit and loss account. Our greater concern is the nature of the requirements and whether the proposals allow for a meaningful, comparable figure to be arrived at in a practical, timely and cost effective manner. The remainder of this letter focuses on those specific areas of the proposals with which we foresee issues.

The minimum disclosure requirements under paragraph 48 are in our view unacceptable, would be commercially sensitive and difficult to interpret without being an expert in option pricing models. We are particularly concerned over the disclosure of share price volatility, expected dividends and assumptions over the achievement of performance measures. The disclosure of expected dividends and performance measures, such as earnings per share or other profit measures, may be construed as a profit forecast which would have significant reporting implications under the listing rules in both the UK and US. Furthermore the disclosure of such forward looking information could have significant legal liability implications where the assumptions are not achieved. We believe the requirement should be for the disclosures to provide sufficient information to understand how the fair value was determined, which should focus on the methodology rather than the specific assumptions.

In relation to the treatment of employee share options the proposals assume the company receives additional services from the employees as a result of granting the option and that the accounts should reflect a cost for those services. The fair value at grant date determined by a Black Scholes (or similar) option pricing model is then deemed to be the cost. Specific issues associated with this approach which we believe need to be addressed include the following:

- In relation to "all employee" share plans such as Save As You Earn ("SAYE") schemes we do not believe that the company receives significant additional services as a result of offering such plans. Such schemes were introduced by companies to support the government's drive to widen share ownership and not as a means of providing additional remuneration to employees. Such schemes do not form part of wage or salary negotiations with Trade Unions. They are not regarded by BT, its employees or its employees' representatives as 'pay'. Rather, they represent a valuable tool for aligning the interests of employees and shareholders. Furthermore in the eyes of the employees and by their nature such schemes are considered to be savings plans rather than a form of remuneration. With over 105,000 employees and 55,000 participants in SAYE plans this is a considerable issue for BT.

  FAS 123 provides an exemption for "all employee" share plans where there is an insignificant discount, which they define in line with their tax regime. We believe the IASB proposals should also provide such an exemption although the allowable discount threshold should be based on the local tax rules rather than an absolute percentage threshold.

  Accordingly, we believe that "all employee" share plans should be specifically excluded from the scope of ED 2. If they are not it is likely that companies will cease to make such saving plans available to employees.

- The data requirements to perform the unit of service based calculations are particularly onerous and can not be satisfied without considerable systems investment to enable our HR and finance systems to interface with our share scheme administrator's database.

  The unit of service calculation is overly complex and we believe that it would be more meaningful and easier to interpret if the cost was simply amortised over the service period with a true up adjustment for actual forfeiture experience at each period end. Given it is a theoretically calculated cost the unit of service methodology gives an inappropriate impression of precision in what is an area of considerable judgement.

- The exposure draft does not deal with circumstances where employees cancel their entitlement to options. The standard should deal with cancellations made by both the employee and the company. Where employees cancel their entitlement we believe that no further charges should be made through the profit and loss account from the cancellation date. This would reflect the company no longer benefiting from the additional motivation and services provided by the cancelled options.

- Where a company cancels a share option for no value we can see no justification and it strikes us as illogical for continuing to make a notional charge against the profit and loss account.

- Where options have an extended exercise period the Black Scholes valuation model may not provide an appropriate valuation methodology. Furthermore, employee share options should not be valued on the same basis as short term market traded options because employee behaviour is not the same as that assumed in the perfect world of an option pricing model. Employees tend to exercise their options early and employees will look at them on the basis of their intrinsic value rather than their fair value based on an option pricing model valuation.

  We believe that further research and guidance is necessary in this area to ensure comparability and transparency of financial reporting between different companies. Furthermore the complexity of option pricing models will mean that the accounts become increasingly difficult to interpret by non expert accountants.

- Complex performance based share options are difficult to value and will require specialist knowledge to interpret. Based on our experience it is possible that professional advisers will not be willing to provide a valuation that can be relied upon for accounting purposes. In such a situation how can the directors and auditors get comfortable that the valuation is appropriate? It may be that there is a need to have an exemption that defers the recognition of the costs until there is sufficient certainty to enable a reliable estimate to be determined. Alternatively the achievement of performance targets could be factored in to the valuation through a probability overlay adjustment to a non performance based Black Scholes valuation.

We believe that the implementation date should be conformed with the implementation of IAS for listed European companies – financial periods commencing after 1 January 2005. We also believe it is inappropriate to apply the proposals to grants made after 7 November 2002 as companies will need to have time to consider the implications of the final accounting standard to ensure that they have are able to source all the required information to comply with the standard.

We would be pleased to discuss our views with you if that would be helpful in addressing the practical issues associated with ED 2.

Yours sincerely

JOHN WROE
Director Group Financial Control
BT Group