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Response from Tate & Lyle

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4 March 2003

Accounting Standards Board
Attn. Paul Ebling
FRED 31 Project Director
Holborn Hall
100 Gray's Inn Road
London
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Dear Sir

ASB FRED 31 / IASB ED2: Share-Based Payment

I am writing to express Tate & Lyle PLC's views on the exposure draft on share-based payments. Tate & Lyle grants employee share options and our comments relate to these. While broadly accepting the principle that share options should be recognised in the financial statements of the issuing company, we have concerns over accounting standards which never reconcile cumulative performance to cash movements, and over the levels and consequences of disclosure. The draft standard gives enough scope for subjective assumptions to distort to the extent that accounting treatments would not be directly comparable between companies.

We have responded only to those questions posed in the exposure draft on which we have stronger opinions.

<u>IASB Question 16</u>

The draft IFRS does not contain prescriptive guidance on the estimation of the fair value of options, consistently with the Board's objective of setting principles-based standards and to allow for future developments in valuation methodologies.

There has been much debate about valuation methodologies and the many flaws these contain. Doubtless the standard will provide the impetus to refine existing models to accommodate performance conditions, very long exercise periods and non-transferability.

The Black Scholes model can value traditional save-as-you-earn ("SAYE") all-employee schemes but shows flaws as soon as other parameters are introduced. Depending on which more sophisticated model is chosen, very different valuations can be derived. We believe the valuation methodologies allow too much subjectivity, which could lead to broad ranges of values.

Thus there is likely to be a lack of transparency and comparability within financial statements. The solution to this weakness in valuation methodology is to require extensive disclosure of all the assumptions used in the valuation. The draft standard relies on sophisticated users of accounts to be able to calculate charges consistently from the disclosures so they can draw meaningful comparisons between companies' performance. The disclosures are unlikely to be made at the time of preliminary announcements and therefore any debate on comparability or transparency is relegated to a more technical level.

We would prefer the ASB to issue guidelines for both preparers and users of accounts. In drafting FRS17, standard-setters presumably faced similar issues of multiple valuation methodologies giving a broad range of outcomes. However, they chose to be prescriptive with the projected unit method. Given the broad design of share option schemes and other share-based payments, we do not believe it would be appropriate for the IASB/ASB to be prescriptive. Rather, we ask the ASB to offer guidance on appropriate valuation methodologies for the most commonly used share option schemes in the UK.

<u>IASB Question 21</u>

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 or 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.

The draft standard requires extensive disclosures. To some extent the need for such disclosure is driven by the subjectivity needed to generate fair value. In our view the disclosures are excessive and we look to the standard-setters to resolve issues with market abuse regulations and not to leave this purely to regulators.

1. There are elements of the fair value calculation, for example the likelihood of performance conditions being met, which rely entirely on a subjective opinion. The vagaries of markets and the macro-economic environment generate sufficient volatility for it to be impossible to measure or audit these subjective opinions, using foresight or hindsight. The high level of subjectivity in choosing assumptions will make it difficult for users of accounts to draw direct comparisons between companies. It is conceivable that analysts and investors will exclude charges for share

options from the performance measures used in their research because of this.

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2. Many share option schemes contain performance-based criteria based upon measures that are reported in published accounts, for example, upon growth in earnings per share. Disclosure of management's estimate of the probability of meeting targets based on future performance could be seriously prejudicial to the company both commercially and in the light of market abuse regulations.

   It is not to be taken for granted that market abuse regulations will be changed to accommodate the draft standard. One can foresee a sub-optimal consequence of the standard whereby share option schemes are redesigned to remove reference to share price-sensitive performance criteria. We believe share options are a valuable tool in remunerating executives who can make a direct impact on the company's performance and shareholder value. We fear that the disclosure requirements in the draft standard could lead to conflicts with market regulators and with commercial sensitivities that could undermine the alignment of management and shareholders, and in turn the effectiveness of share options.

3. To the extent that dividends are included within the valuation methodology adopted and therefore have to publish assumptions about future dividends, companies may lose flexibility over their dividend policies.

4. More specific guidance on the valuation methodologies to be used in particular circumstances would enable a reduction in the proposed extensive disclosures, thereby limiting these issues.

<u>IASB Question 10</u>

In an equity-settled share-based payment 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, even if the equity instruments granted do not vest or, in the case of options, the options are not exercised (paragraph 16). However, this requirement does not preclude the entity from recognising a transfer within equity, ie a transfer from one component of equity to another.

The proposed standard appears to break with a fundamental principle of performance reporting, which is that ultimately accounts prepared under the accruals concept should cumulatively reflect cash flows. Given the complexity and subjectivity of the fair valuation process, it will be extremely difficult to reflect the true cost of granting options to employees at date of grant.

We are concerned that the draft standard does not give clarity regarding distributable reserves. We would wish to see distributable reserves ultimately reflecting the true cost to a company of share-based payments rather than that estimated at the time of grant. We would ask for further clarification in the drafting process regarding the nature and timing of any transfers permitted within equity.

IASB 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.

We believe SAYE options which are available equally to all UK employees should be exempt from the scope of this standard. They are a unique contract between employees and shareholders. They are not linked to remuneration of the employee, but to the ability and willingness to save. As such they do not form part of the remuneration of an employee and therefore, in line with the logic expressed in the draft standard, should not be charged as a service to the company. Research indicates that greater shareholder value is generated by companies which grant SAYE options, as ownership or potential ownership of shares in their company aligns employees with shareholders' interests.

We trust you will find our comments helpful in your deliberations.

Yours sincerely

Simon Gifford
Group Finance Director