

Marks & Spencer p.l.c.
Michael House
Baker Street
LONDON.
W1U 8EP

Tel. 0207 935 4422

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

CL 227

... Date 22 April 2003

Dear Sirs,

FRED 31 – SHARE BASED PAYMENT

We agree with the principle that there should be a charge to the Profit and Loss account for the services rendered (or goods received) in return for share-based awards. We are pleased that the proposals are based on grant date as the relevant measurement date as this is what we suggested in our response to the Discussion Paper in October 2000. However, we still have several major concerns we wish to highlight before responding to the ASB specific questions. (We will not be responding specifically to the IASB questions):-

Practical Issues

We are concerned about the practicalities of collecting and applying all the necessary data and also the sensitivity of the results to much of the data. It should not be underestimated how much work will be involved for companies to collect the most appropriate data for all their different share schemes (see in particular the following paragraph on Employee Turnover), and this was borne out by the experience of field testing in which we have recently participated. Even the very largest of companies will require a significant amount of advice and help in order to select the most appropriate option pricing model and will probably require advice on the inputs to that model.

Additionally, the interpretation of the outputs from the model is not straightforward, particularly given the sensitivity of the results to inputs such as share price volatility. In our recent field testing we found, for example, that a 5% variation in the volatility could have a significant impact on the charge. Comparability is a key principle for financial reporting and we believe that this will be hard to achieve for share schemes given the range of possible inputs and the sensitivity of the results to those inputs.

Employee turnover

We are concerned in particular about the practicalities of predicting and collecting the most relevant employee turnover data. Whilst more basic employee turnover statistics are readily available it is much harder to relate these to a specific share scheme membership, for which it may be necessary to have a qualifying period of service. We struggled to gather the appropriate data together for our field testing as it involved non-standard interrogation of our payroll system.

We believe that it may be more straightforward, and indeed more accurate, to consider a method which does not estimate the fair value of each 'unit of service' up front. Correcting adjustments could then be made as and when employees leave.

Disclosures

We believe that the volume of required disclosures is excessive and out of all proportion in relation to the size of the charge compared to a company's overall Profit and Loss account. Much of the data will be incomprehensible to all but the most 'sophisticated' of users. Further, we believe that some of the disclosures are extremely sensitive (and possibly in breach of the Listing Rules), e.g. the requirements to disclose expected dividends and the assumptions made with regard to vesting conditions (paragraph 48) which for many companies would involve disclosing expected EPS growth.

The Board should consider reducing these disclosures, in particular the ones which are price sensitive.

Credit side of entry

There is almost no discussion in the draft about the 'credit' side of the entry and this needs clarification. The draft simply talks about a 'credit to equity' and then about possible subsequent 'transfers between components of equity'. What are these components and what does this side of the entry truly represent, particularly in the case where options or shares never vest?

SAYE Cancellations

During periods over which a company share price falls significantly, it is common practice for employees to cancel their SAYE savings contracts partway through, collect their savings, and immediately take out a new replacement SAYE contract (which obviously has to run for the full period). We believe that in this instance it would be extremely unfair for charging to continue since these cancellations tend to occur early on in the life of a savings contract. It is essential that consideration is given to the modification rules (paragraph 29 of the draft) to ensure that the cancellation of SAYE contracts is covered under these and in particular where new replacement savings contracts are taken out. If this is not done it will lead to a doubling up of the charge to Profit and Loss. In one year alone, Marks & Spencer had contracts for

around 7 million SAYE options cancelled and in nearly all instances these were immediately replaced by new savings contracts.

ASB Question 1

The ASB is proposing to require the adoption in the UK of a standard based on the proposed IFRS from the effective date in the IFRS (which is expected to be accounting periods beginning on or after 1 January 2004). Do you agree with this approach?

No, we would prefer the effective date to be for accounting periods beginning on or after 1 January 2005. This would be in line with Europe and would allow more time for general international harmonisation, e.g. with the United States.

ASB Question 2

The IASB has concluded that its standard should apply to all entities. The ASB does not believe there are any conceptual or practical reasons why that conclusion should not apply equally in the UK. It is therefore proposing that *all* UK entities, other than those that are applying the FRSSE, should be required to prepare their financial statements in accordance with the proposed standard. Do you agree with this proposal?

Yes we agree.

ASB Question 3

The IASB has concluded that its standard should apply to all types of share-based payment transactions, including SAYE-type share purchase plans. The ASB does not believe there are any additional UK considerations that would justify a different conclusion being reached in the context of UK accounting. Therefore, like the IASB the ASB is proposing that the standard should apply to *all* types of share-based payment transaction. Do you agree with this proposal?

We believe that consideration should be given to exempting SAYE schemes on the grounds that they represent a form of saving which is taken out at the discretion of the employee. We do not believe that an employee who takes out an SAYE contract works any harder than an employee who does not do so.

There are also public policy arguments for excluding all employee share schemes. For some time now, the UK Government has had a policy of promoting wider share ownership. Employers already suffer significant costs in administering these schemes and we believe that if these additional costs for all employee schemes are charged against profits then companies will be discouraged from creating new schemes for their employees and employee share ownership will fall significantly.

ASB Question 4

The IASB is proposing that its standard should apply equally to all individual entity financial statements and consolidated financial statements, regardless of whether for

example the reporting entity is a wholly-owned subsidiary of a group that prepares consolidated financial statements or a parent company that also prepares consolidated financial statements. The ASB does not believe there are any additional UK considerations that would justify a different conclusion being reached in the context of UK accounting and is therefore proposing to adopt the same approach as the IASB. Do you agree with this proposal.

Yes we agree.

ASB Question 5

The ASB is proposing that, when the share-based payments standard is implemented in the UK, the ASB should withdraw UITF Abstract 10 ‘Disclosure of directors’ share options’ (if it has not already been withdrawn by then), UITF Abstract 13 ‘Accounting for ESOP Trusts’, and UITF Abstract 17 ‘Employee share schemes’. It also acknowledges that consequential amendments may need to be made to UITF Abstract 32 ‘Employee benefit trusts and other intermediate payment arrangements’.

- (a) Will these amendments to existing UK requirements be sufficient to enable entities to adopt the proposed standard without being in breach of an existing requirement?**
- (b) Are any of the amendments unnecessary for this purpose?**

No comment.

ASB Question 6

The FRED proposes that entities should be required to apply the requirements of the standard to equity-settled share-based payment transactions that were granted after the publication date of the FRED but had not vested at the effective date of the standard. Full retrospective application would not be permitted (unless it can be achieved through early adoption) and nor would prospective application. Do you agree with this proposal?

No, we do not agree with this proposal since we do not think it is appropriate for a standard to be semi-retrospective in nature. We believe it would be more appropriate for the relevant date to be the publication date of the standard since the details in the FRED had not been agreed at the date of publication of the FRED. Also this will give companies more time to ensure that they can capture all the necessary data in an appropriate format.

We also believe, for the same reason, that the standard should not be retrospective in nature.

Yours faithfully,

M.A. LENZ

Chief Accountant

Direct Line: 0207 268 6382

Email: tony.lenz@marks-and-spencer.com