

7 March 2003

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

Dear Madam

Exposure Draft on Share-Based Payments

We are pleased to provide you with our comments on the Exposure Draft on the treatment of Share-Based Payments. The proposals are set out in Exposure Draft 2 issued by the International Accounting Standards Board in November 2002.

In principal, we welcome the proposals contained in ED2. In particular, we welcome the proposal that the fair value of equity instruments should be measured at the date of grant of the share-based payment.

We support the ED's recommendation that the fair value of options granted could be measured using an options pricing model. In particular we agree with the ED's proposals to allow for vesting conditions to be taken into account either by incorporating them into the application of the options pricing model or by making an adjustment to the value produced by such a model.

We agree with the ED's proposals in relation to repricing but it is our view that the following instance should be exempt from the requirement to reprice.

- We do not believe that repricing should apply where a new employee share scheme akin to a UK Save as You Earn ("SAYE") scheme is opened and all employees are entitled to withdraw their monies from the original scheme and invest those monies in the new scheme. For example, if an employee chose to withdraw £500 from share option scheme A and reinvested that £500 into another scheme B we do not believe that it would be appropriate to fair value that reinvestment in B. Instead we believe that the fair value at the date the option was originally granted in relation to the original scheme A should remain and Scheme B should be regarded as an entirely separate compensation item. We believe that the IFRS should expressly indicate that such an arrangement is not regarded as repricing, although this would differ from US EITF 00-23.

We agree in principle with the IASB's proposals in relation to fair valuing and the recognition of the related expenses to the profit and loss account on the basis of unit of service. However, please note that we would not wish the calculations in relation to attributing fair value to unit of service to be overly detailed or onerous.

There are 2 other points that ED2 is silent on which we think should be addressed in the full IFRS:

- We would suggest that clarification is needed in relation to the deferred tax implications of ED2; and
- The calculation of diluted EPS in relation to the inclusion of share based payments needs to be addressed, as under the current proposals companies would have a 'double hit' under this measure.

Please find enclosed with this letter answers to the Invitation to Comment questions in the ED itself.

Please do not hesitate to contact me if you require clarification on any of our comments.

Yours faithfully,

Nicola McNaughton
Group Financial Accountant

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Responses to the Invitation to Comment questions raised in ED 2

Question 1

We do not believe the proposed scope is appropriate. We think Sharesave schemes should be exempt from ED2 as we do not believe they constitute a form of compensation rather we believe that they encourage employees to invest their savings in shares and therefore encourage wider share ownership.

Question 2

We think the recognition requirements are appropriate as an expense is recognised when goods are consumed or over the period services are received. This is consistent with how you would account for a normal cash purchase.

Question 3

Yes, as a listed company we agree with the measurement principles suggested. However, we do note that obtaining the fair value of equity securities may be more difficult for unlisted companies.

Question 4

Yes we agree that where the fair value of goods or services are measured directly, the appropriate date to measure fair value would be the date when the entity obtains the goods or receives the services.

Question 5

Yes we agree that the grant date is the appropriate date to measure the fair value of equity instruments granted.

Question 6

Yes we would agree that for transactions with parties other than employees, the fair value of goods or services received is more likely than not to be the more readily determinable measure especially when considering that this ED applies to unlisted companies as well as listed ones.

Situations where this might not be appropriate would be those situations in which the goods or service received is unique to the company. Fair value of the good or service in this instance may be more judgemental than the fair value of the equity instrument.

Question 7

Yes we agree that the fair value of employee services is more difficult to determine than the fair value of equity instruments.

Question 8

We would suggest that it would be more appropriate to recognise the expense over the period in which services are received by the company rather than over the vesting period. This is more representative of the actual period in which value is received. Please note however that we would expect these to be the same in practise.

Question 9

We agree with the IASB's proposals in relation to fair valuing and the recognition of the related expenses to the profit and loss account on the whole. However, please note that we would not wish the calculations in relation to attributing fair value to unit of service to be overly detailed or onerous.

Question 10

Yes we would agree with the proposed treatment as long as the transfer between components of equity was allowed. The original recording of the transaction was based on what both parties had originally assessed the fair value of the service as being and therefore should not be reassessed. A transfer between equity components should reflect any change for options not being exercised as the ED proposes.

Question 11

We agree that an option pricing model should be applied to estimate the fair value of options granted taking into account the factors mentioned in the ED. However, the IASB should be aware that the assumptions used in applying an options pricing model can be varied to produce a whole range of possible outcomes. Simply applying an options pricing model does not remove the subjectivity.

Question 12

Yes we would agree that using the expected life rather than the contracted life is an appropriate means of adjusting the options fair value for the effects of non-transferability.

Yes we would also agree that the proposed requirement for taking into account the inability to exercise an option during the vesting period is appropriate.

Question 13

Yes we do agree that vesting conditions should be taken into account when estimating the fair value of options or shares granted.

Question 14

We think that only one option should be available in relation to reload features to ensure comparability between companies remains. We think the option that is most appropriate would be to account for the reload feature as a new option grant. Our reason for this is that the reload feature is being measured at the date it effectively comes into force and can be measured at that date with more up-to-date and accurate information.

Question 15

We are not aware of any other common features.

Question 16

We agree with the approach provided.

Question 17

We do not believe that repricing should apply where a new employee share scheme akin to a UK Save as You Earn ("SAYE") scheme is opened and all employees are

entitled to withdraw their monies from the original scheme and invest those monies in the new scheme. For example, if an employee chose to withdraw £500 from share option scheme A and reinvested that £500 into another scheme B we do not believe that it would be appropriate to fair value that reinvestment in B. Instead we believe that the fair value at the date the option was originally granted in relation to the original scheme A should remain and Scheme B should be regarded as an entirely separate compensation item.

We believe that the IFRS should expressly indicate that such an arrangement is not regarded as a repricing.

Question 18

Where a share or option is cancelled during the vesting period we agree with the ED's proposals that the services should continue to be recognised over the remainder of the vesting period.

Question 19

We agree with the proposed requirements of the ED.

Question 20

We agree with the proposed requirements of the ED.

Question 21

We do not agree with the proposals contained in the ED in relation to disclosure requirements, as we believe these to be unduly onerous. If the IAS believes that the proposed ED will lead to a company recording a reasonably accurate share based payment in its profit and loss account then surely not all of the disclosure requirements contained within the ED are necessary. Furthermore, we would question whether the disclosures would be understood by users of financial statements.

One of the disclosure requirements contained within the ED is for the expected dividends assumption used in the options pricing calculation to be disclosed. This would lead to the disclosure of information that potentially contravenes the UK Listing Rules as this is equivalent to a dividend forecast.

Question 22

We would suggest that the requirements of the ED only apply to grants of equity instruments after the issue date of the full IFRS.

Question 23

We would agree that the proposed requirements are appropriate.

Question 24

- (a) We believe that the ED should incorporate the exemption from SFAS 123 in relation to employee share purchase plans for the same reasons mentioned in our response to Question 1.
- (b) We prefer the IASB's proposals in relation to both treatments highlighted.
- (c) We agree with SFAS 123's suggestion that the instruments are treated as if they have immediately vested as there could potentially be an incentive for companies to grant an equity instrument in lieu of a cash bonus, propose to

recognise it over a 3 year vesting period but almost immediately settle in cash. The effect is that of a cash bonus that should be expensed immediately however using the guise of ED2 companies could recognise it over a 3 year period.

- (d) We agree with the IASB that grant date be used in all cases.
- (e) We agree with the IASB's approach.
- (f) We agree with the IASB's approach.

Question 25

We have no other comments in relation to the ED other than those set out in the main body of our letter.