



Mr Bob Herz  
Chairman  
Financial Accounting Standards Board  
P.O. Box 5116  
USA-Norwalk, Connecticut 06856-5116

Letter of Comment No: 5297  
File Reference: 1102-100

24 June 2004

Dear Mr Herz,

**File Reference No. 1102-100**  
**Proposed Statement of Financial Accounting Standards,**  
**Share-Based Payment**

On behalf of the European Round Table of Industrialists (ERT), I am pleased to respond to the invitation of the Financial Accounting Standards Board to comment on the Proposed Statement of Financial Accounting Standards on Share-Based Payment, an amendment of FASB Statements No. 123 and 95.

ERT is a group of CEOs and Chairmen of large European industrial companies. ERT has created several Working Groups, covering most of the aspects of European Union (EU) economic life, amongst them, an International Accounting Standards Working Group which supports the development of IFRS and convergence among standard setters, thus reflecting the views of large multinational companies as preparers of accounts. Many ERT companies have their shares listed both in Europe and in New York and therefore welcome the proposed standard being similar to International Financial Reporting Standard (IFRS) 2, issued by the International Accounting Standards Board (IASB). They also support your decision to make expensing of stock options and related benefits compulsory.

***Convergence***

ERT companies endeavour to find the appropriate balance between providing relevant and meaningful information to stakeholders and limiting the cost of collecting and reporting this information, a cost that is ultimately borne by shareholders. In addition, we are conscious of the, in itself deplorable, fact that accounting standards across the world are not harmonised. This may result in distortions in the level playing field for international companies when new standards are introduced in a certain jurisdiction that are fundamentally different from those applicable in other jurisdictions. Not only does this reduce comparability; it potentially creates a competitive disadvantage for companies that are forced to disclose more or different information than their competitors reporting under a different GAAP.

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In this respect, we welcome the fact that the Proposed Statement is broadly in line with the equivalent standard from the IASB. We note however that some burdensome differences remain and we urge the Board to continue its dialogue with the IASB to remove the remaining differences in the final standard. We will comment on these in the remainder of this letter. With respect to convergence, it needs to be mentioned that this is not only a matter of content but also a matter of implementation dates. The date from which expensing share-based payments becomes compulsory should be the same under IFRS and US GAAP.

### ***Fair-Value Measurement***

The Proposed Statement expresses a strong preference for lattice models as the basis for the determination of the value of share-based payments, whereas the IASB and also SFAS No. 123 do not express a preference for either lattice models or closed-form models. Research into the application of option pricing models for accounting valuation purposes has consistently shown that the Black-Scholes model is applied by a large majority of companies. The strong preference now being expressed therefore differs from existing practice and will force many companies to change their accounting/disclosure with respect to share-based payments. We understand the conclusion of the Board that lattice models can in theory be expected to provide a more accurate valuation because such models can accommodate estimates of employees' option exercise patterns, nontransferability of the options and other relevant variables. Therefore they are conceptually superior. However, they are also more difficult to apply in the sense that they require more information that is not always easily available (e.g. historical exercise behaviour) and possibly of limited reliability. Therefore application of lattice models can be expected to be more costly, both from an information-gathering and from an audit perspective and, in the end, this cost does not provide a commensurate benefit. Any claim to greater accuracy must be viewed in the context that we are applying a model to arrive at a fair value based on subjective assumptions, which is in any event being used as a proxy to indirectly measure another item i.e. services rendered. We read the proposed statement as requiring companies to apply lattice models in all those cases where the relevant information is available and request you at a minimum to change this into a recommendation that is not binding.

### ***Accounting for income taxes***

The Proposed Statement requires deferred taxes to be determined on the basis of the fair value of the instrument that is recognised as compensation cost. Subsequent changes in the share price are not reflected in the subsequent measurement of the deferred tax asset, whereas IFRS 2 requires the deferred tax asset to be remeasured based on the share price at each reporting date before the tax benefit is realised. That this difference remains is contrary to the Norwalk Agreement between the FASB and the IASB and highly undesirable for dual listed companies, who will face considerable administrative burdens as a consequence. Such a burden is unjustifiable, certainly in this case where investors will clearly not obtain better or

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additional information as a result. We urge you to continue your dialogue with the IASB and to agree on a position that is identical. We have a strong preference for the treatment that you currently propose because of its practicality and because it will avoid those who already apply SFAS No. 123 having to change their existing accounting.

### ***Employee share purchase plans***

We note with concern that the criteria for employee share purchase plans to be considered non-compensatory are being tightened further. The proposed limitation to plans that have terms that are no more favourable than those available to all holders of the same class of shares, results in a drastic change from current practice and will make virtually all employee share purchase plans compensatory. The option features of such plans are very limited and the discount that is typically provided is motivated by the fact that employees buy the shares directly from the company, thus avoiding transaction costs. It is a way of facilitating share ownership with employees who will often be deterred from buying the shares in the open market because the small scale of their individual purchases would make transaction costs prohibitive. The argument of the Board that the benefit provided to the employees is unrelated to the possible role of employees as holders of equity instruments is therefore incorrect. In addition to this argument, we note that the existing 5 percent limitation to the discount makes the overall amounts involved in these plans hardly significant, whereas the additional administrative burdens that arise when these plans become compensatory can be considerable. Ultimately, the shareholders pay the bill because the company incurs more cost without any significant improvement in the information that is available to the shareholders. We are aware of the fact that our suggestion to maintain the existing accounting for employee share purchase plans, as mandated by SFAS No. 123, would create a divergence with IFRS 2. Both Boards are currently proposing or mandating an accounting for these plans that is conceptually flawed and we urge both to reconsider their position in this respect.

### ***Employee-stock-ownership-plans (ESOPs)***

We welcome your decision to continue the accounting for ESOPs in accordance with AICPA Statement of Position No. 93-6 that we find appropriate for this purpose. We are aware that this is a divergence with IFRS but are willing to accept this in view of the fact that the treatment mandated by the IASB disregards the objectives of such plans.

### ***Scope***

Due to the fact that the FASB continues to scope-out awards to non-employees, this will remain an area for divergence with IFRS.

### ***Common language***

For the sake of convergence and transparency in the global capital markets, we recommend that you work together with the IASB on the development of a common glossary of terms that is used consistently in accounting standards. A very rigorous and consistent usage of English is necessary to ensure a proper understanding of proposals and final standards. Published materials need to be understood and applied consistently across the world, in many cases by users who do not have English as a first language. This applies equally to IASB and FASB pronouncements, in the latter case due to the large number of foreign issuers that are listed on US markets. Therefore English words that may have more than a single meaning must be used very consistently. In addition to using the same language, the Boards are urged to avoid jargon and overly complex technical terms. Standards and related texts should be written in plain English. An agreed and disclosed glossary should be consistently applied through the standard-setting process.

Our comments to the proposed Standard are driven by a commitment to be able to provide relevant and meaningful information to investors. We trust that they will receive careful consideration from the Board and that the subjects discussed will be addressed in the final standard. In summary, we support the Board in its proposal to introduce expensing but we urge you to work towards maximum convergence with IFRS, both to avoid that the level playing field is disturbed and to ensure reliability and comparability of financial information. As you will see from the above points, we believe this requires not only changes to your exposure draft but also changes to IFRS 2.

Should you need further clarification or additional information on the points addressed in this letter, please do not hesitate to contact me.

Yours sincerely,

A handwritten signature in black ink that reads "Wim Philippa". The signature is written in a cursive, flowing style.

Wim Philippa

Secretary General