CL 216

Response to FRED 31 from Robert Walters Plc

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?

The principle that there is inherent value in the granting of share options and that it should therefore be reflected in the profit and loss account is an understandable reaction from not only accountants, but also institutional representative bodies of shareholders.

Global harmonisation is also an understandable goal.

The key difficulty with the suggested approach is that it requires a future value of an option to be ascribed at the time of the initial grant.

Given the volatility of stock markets, even to set out the parameters to predict a future value borders on the implausible. Any attempt to accrue for future charges will lead to an "imaginary" creditor that will potentially materially distort the true nature of the balance sheet.

To accept this premise and only book a charge to the profit and loss at the point that any gain on share options is realised for an individual will have the following significant drawbacks:

- *Distortion of the profit and loss account*
- *Further distortion to the balance sheet (along with FRS 17) which is arguably a core fundamental view of value, particularly as sanity returns to financial markets following the dot- com crash*
- *A further incentive for management to attempt to resort to creative legal structures to avoid booking such charges – with the best will in the world to draft an all encompassing FRS, history points to the fact that creative solutions will be found to avoid such charges to the profit and loss account*

Whilst I have not been closely involved in the initial discussions of the FRS, on a first principle basis, the cost of a share option to management to a current shareholder is the potential dilution effect.

There are a great deal of persuasive arguments, not the least of which is the opportunity for certainty, to book a cost to the profit and loss account relative to the discount to price of an option based upon the net asset value per share presently.

The earnings per share measure also presently exists to provide a benchmark on the effect on earnings – an analysis of what this would reflect in terms of value on a current p/e value of the existing share as a part of the accounts could potentially be meaningful and highlight the potential value that is being transferred to management, but given the vagaries of share price and company performance, I would strongly argue that this should not then be incorporated into the body of the profit and loss and balance sheet.

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?

Conceptually, this appears sound, but on a practical level it will increase the costs associated with share options and may deter entrepreneurs away from share option schemes. In my view this would be a negative result

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?

As per question 2, although it is also likely to deter listed companies away from SAYE schemes as they already prove costly to administer

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?

As per question 2, this approach is conceptual rather than necessarily practical.

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?

I am not entirely clear on what is being asked.

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? (IASB Question 22 also focuses on the transitional requirements set out in the proposed standard.)

Given the difficulties that still remain, this has the effect that businesses need to take material and difficult decisions based on a very poor level of understanding

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