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Mr Paul Ebling
Accounting Standards Board
Holborn Hall
100 Gray's Inn Road
London
WC1X 8AL

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Dear Sir

**Comments on FRED 31: "share based payments"**

This letter outlines the views of Detica Group plc on the above exposure draft.

*Summary (ASB Question 1)*

Detica disagrees with the accounting treatment for share-based payments proposed by FRED 31. Share options are a cost to shareholders, not the company, and as a result, we believe that the conceptual basis for the proposed policy for share-based awards granted at full market value is flawed. The proposal policy results in the provision for costs that may never be incurred, using valuation methodologies and principles which are inappropriate and inconsistent. The proposed treatment will distort the interpretation of the underlying trading performance and the company's financial position.

In summary, we believe that the proposed standard will do nothing to improve the relevance or reliability of a company's financial statements.

*Introduction*

Detica is a UK based IT services company involved in consultancy and system integration activities. The company listed on the London Stock Exchange in April 2002 and currently has a market capitalisation of £67 million. Detica is a member of the FTSE Small Cap index, as well as the TECHMARK 100. Detica reported Turnover of £32.8 million for the year ended 31 March 2002 and pre-tax profits of £4.4 million. We currently employ around 330 staff.

Detica has a very long history of employee share ownership and staff equity participation is an important element of our human resources strategy. Approximately 70% of our staff own shares in the company, representing just under 40% of shares in issue. A requirement for entry into all of the company's share option plans is that members of staff must first purchase shares in the company at full market value. This shareholding requirement is a fundamental tenet of our approach to employee share ownership and gives staff a direct interest in the financial success of the company, not just in the upside, as is the case with share options. We employ a number of share incentive arrangements.

*Flawed conceptual case*

For option awards granted to staff at full market value, we fundamentally disagree with the conceptual case put forward in FRED 31. Share options granted at full market value do not represent a cost to the company. They represent a cost to shareholders.

Whilst share-based arrangements do provide potential benefits to the holders of awards, they represent a transfer of value between two sets of potential investors, and not by the company itself. Other “costs” incurred by investors, such as unrealised gains and losses through share price fluctuations, and the opportunity costs of investment decisions, are not expensed through the investee company. It is inappropriate and inconsistent to treat share-based payments in this way.

The inclusion of the dilutive impact of share options within earnings per share represents the measure of the cost of share options to existing shareholders. The proposed profit and loss treatment is a double charge on diluted EPS.

The expensing of the fair value of share-based payments introduces costs that the company itself will never in practice incur or settle.

The proposed balance sheet treatment is illogical. The capital base of the company is unaffected until awards actually vest and measurements such as gearing could be adversely distorted.

*A retrograde step for employee share ownership (ASB Question 3)*

Staff share ownership is growing across Western Europe, rapidly developing as best practice in successful companies. Share ownership offers staff the opportunity to share in the success of the business, with financial incentives for working together to reach common goals and sharing a vision through the creation of the 'Owners' Eye'. The UK Government has over the last 5 years strongly promoted employee share ownership, though the granting of tax concessions such as Enterprise Management Incentive schemes, Share Incentive Plans and the widening of business asset taper relief.

We are concerned about the implications of the proposed new accounting standard on the trend towards employee share ownership. We strongly argue for the exemption from the proposed rules of all employee share schemes, such as Save-As-You-Earn and Share Incentive Plans. We believe that all employee schemes are fundamentally different from executive plans.

*Flawed valuation basis*

Even though we do not agree with the introduction of the standard, we also have concern about the valuation methods and rules proposed by the standard itself.

Black-Scholes and other valuation methodologies have well publicised flaws and were devised to value three to six month traded options rather than longer term equity incentives.

Whilst the volatility in a company's share price may be high, share prices have in reality fallen for the majority of listed companies over the last 3 years. Volatility measures take no account of this overriding trend and are intuitively inappropriate. Whilst it may be possible under Black-Scholes to ascribe financial values to options, would employees really recognise this if share prices have done nothing but fall in recent years?

The lack of a market in longer-term tradable options for many listed companies indicates that there is no effective way of valuing share options for many companies. The market would have risen to the opportunity if such methods existed.

*Illogical rule on forfeiture*

The proposed rules governing forfeiture of share-based payments are inconsistent and inappropriate:

- With share-based payments, whilst allowance can be made in calculating the annual P&L charge for staff turnover, no retrospective allowance is permitted where performance conditions are not achieved, or options are "underwater." This is illogical and is analogous to providing for bonuses all full fair value even though they are not paid.

- For cash-settled share based payments, companies may accrue costs based on actual performance, and make adjustments where conditions are not achieved. The proposed treatment for share –based payments is not logically consistent with this approach.

We have welcomed the opportunity to put forward our comments on the proposed standard and to outline our principal issues. We have not attempted to comment on all areas of the standard, and many of the concerns voiced in our letter are, I am sure, well known to the Board.

There is a well-publicised view that the very short deadline for comments on FRED 31 implies that the Board is not committed to consultation on this standard. Where this to be the case, we would be concerned.

Yours faithfully

Andrew Alcock
Finance Director