CL 208

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

Dear Mr Ebling

Financial Reporting Exposure Draft 31
Share Based Payments

I am Finance Director of a young and still small biotech company. The company was founded in 1998 and is growing very successfully. The directors aspire to taking the company onto a market, probably OFEX initially but moving to AIM later. As such we believe it important to adhere to the highest standards in presenting the company's accounts, so we do not attempt to take advantage of small company disclosure exemptions.

The company relied in its early stages in recruiting, motivating and retaining staff by the use of share options, particularly as they have been so strongly encouraged by the government through measures such as EMI incentives. We have however been badly affected by the application of UITF 17, as the options granted were at an exercise price which was at a discount to the 'market value'. I enclose a copy of the latest Profit and Loss Account and Balance Sheet to illustrate the outcome.

The impact of this on the P/L has, as you can see, been dramatic. For example I have problems in giving these figures to companies with whom we would wish to trade on credit – having to explain that the big negative figure in the P/L does not actually affect the company's creditworthiness is invidious.

Even more surprising, you will agree, is that when I have discussed the company with potential Nominated Advisors as a precursor to arranging for the company to be introduced onto OFEX, they have looked at me askance as they tried to understand the company's trading performance.

If you accept that relatively sophisticated users of accounts such as these are unaware of the impact of current accounting standards and the 'charges' that bring about, and if they agree with me that they are an unwelcome confusion, then you will have some understanding of the problem that my fellow directors have in seeing what are real figures and what are not in the accounts. While they have an understanding of 'conventional' accounting presentations they view the impact of UITF as irrelevant – at the very least. For me it means that I have a most unwelcome hindrance in trying to demonstrate to them, and of course other users of our accounts, that the accounts should be regarded with respect.

Of course there is a theoretical argument that the cost of services provided to the company should be recognised. Absolutely! But not in the P/L.

In particular when I have to explain to users of the accounts that the answer to each of the following questions:

Does it affect our cash?
Does it affect our tax liabilities?
Does it affect our distributable reserves?
Does it affect our shareholders' funds?

is 'No' then I am not going to succeed in maintaining the standing of the Statutory Accounts, am I?

The purpose of this letter is of course to comment on FRED 31. As far as UITF 17 is concerned we are reacting to it now that we see its impact by ceasing to issue options at a discount. FRED 31 however threatens to bring in a far less understandable and far more theoretical concept which will affect the headline figures in accounts. I would therefore like to comment on the FRED as far as it relates to share options, as this is the area in which I have some (admittedly modest) experience. I shall not comment on the other aspects of the FRED as I do not have relevant experience of them.

FRED 31 is being adopted because it is intellectually satisfying to the high-minded theoreticians who have the power to set standards. They are going to repeat what I saw as an auditor in the 70's with the accounting standard which required accounts to be adjusted for the effects of inflation. It simply undermined the credibility of published accounts and the standing of the accounting profession. It appeared theoretically right but was in practice simply useless.

UhF 6 which obliged companies to disclose post-retirement benefits in their accounts is to be applauded. It made companies realise what they were doing – I speak from experience there. The fact that cash would go out of the company in the future as a result of decisions made today was highly relevant and could only be brought home to managers in this way. FRED 31 however is going to affect measurement of a company's performance with a measure of the impact on shareholders' equity. These are different things and should not be mixed together.

I thoroughly agree that the impact of share options issued should be disclosed – but not in the P/L! It should be disclosed in a way that shareholders will be able to comprehend, and not in a manner which will confuse many and satisfy only a few high-minded groups of (superior?) people. The ASB appears to be intent on following the US practice of making accounts so impenetrable that users cannot see the wood for the trees (dare I say it: Enron etc. etc. etc. ...).

Even if the ASB is prepared to acknowledge the concerns I have they are likely to retreat behind principles from the accounting Framework so that we will blindly end up having to <u>recognise</u> this ‘charge’ on the face of the accounts instead of <u>disclosing</u> it.

What would be useful would b disclosure in a note to the accounts which stated (what I outline here is obviously very basic and would need fleshing out) the number of shares currently in issue, the number of share options now issued, the exercise price of those options and the % impact of the foregoing on the *current* share price. Now not only would that have the virtue of simplicity and objectivity (limited only by unquoted companies having to estimate a current share price) but it would be understood by most people.

A further, and related, aspect of this issue has recently affected my company. I have been attempting to obtain comparative information on competitor companies. For a small company like ours it would be extremely helpful to get some indications of what we might be able to achieve by looking at them. Most of these companies are in the US or Europe. However – almost universally they do not publish any accounts. So they will not be hindered or confused by abstract accounting concepts such as these. Why does the ASB not turn its attention to ensuring that all countries oblige disclosure of companies’ accounts? That would be useful!

Bringing this letter then to a conclusion – for I fear that the opinion of someone as insignificant as me will easily be set aside – I and many others will end up facing the burden (and it wUl be a time-consuming burden to apply the standard – I have a lot of other work to do in the business). The ASB is taking us down a road where the US has gone and the standing and credibility of the accounting profession and of published accounts are going to be eroded by this proposed standard.

Yours with dismay

PROFIT AND LOSS ACCOUNT Year ended 30 June 2002	Note	Year to 30.6.02 £	Year to 30.6.01 £
TURNOVER: continuing operations	2	1,804,321	719,559
Cost of sales		(820,647)	(416,097)
Gross profit		983,674	303,462
Administrative expenses		(967,682)	(698,184)
Exceptional charge in respect of share options granted to employees		(409,512)	(112,940)
		(393,520)	(507,662)
Other income		9,127	34,465
OPERATING LOSS: continuing operations	4	(384,393)	(473,197)
Interest receivable and similar income		2,462	5,905
Interest payable and similar charges	5	(21,076)	(4,617)
LOSS ON ORDINARY ACTIVITIES BEFORE TAXATION		(403,007)	(471,909)
Tax credit on loss on ordinary activities	6	74,800	-
RETAINED LOSS FOR THE FINANCIAL YEAR TRANSFERRED TO RESERVES	7	(328,207)	(471,909)

There are no recognised gains and losses for the current or preceding financial years other than as stated above.

The statement of movements on reserves is shown in note 7.

ABCAM LIMITED

30.6.02 30.6.01

BALANCE SHEET
30 June 2002

Note

8
9
10
11
12
13
14

£ **£**

FIXED ASSETS

Tangible assets
Investments

86,557

257,30

CURRENT ASSETS

Stocks
Debtors
Investment: cash deposit
Cash at bank and in hand

5

7
7
7

as restated
(see note 12)

CREDITORS: amounts falling due within one year

NET CURRENT ASSETS/(LIABILITIES)

TOTAL ASSETS LESS CURRENT LIABILITIES

CREDITORS: amounts falling due after more than one year

NET ASSETS

CAPITAL AND RESERVES

Called up share capital
Share premium account
Other reserves
Profit and loss account

10	2
86,567	257,307
69,432	18,126
397,938	215,331
170,000	70,000
59,127	17,326
696,497	320,783
(432,182)	(501,574)
264,315	(180,791)
350,882	76,516
(175,583)	(56,822)
175,299	19,694
23,345	23,196
755,307	681,156
522,452	112,940
(1,125,805)	(797,598)
175,299	19,694

TOTAL EQUITY SHAREHOLDERS' FUNDS
17

These financial statements were approved by the Board of Directors on Signed on behalf of the Board of

Directors

ABCAM LIMITED

E W Powell