IRISH PROSHARE ASSOCIATION

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

28/02/03

Re: Proposed New Accounting Rules for Share-Based Payments

Dear Ms Crook,

The Irish ProShare Association (IPSA) would like to take this opportunity to communicate its view on the introduction of an accounting standard, as proposed by both the Accounting Standards Board (ASB) and the International Accounting Standards Board (IASB), for equity based compensation.

The IPSA is aware that many of the concerns that surround employee share ownership relate to executive schemes only, however, it is our firm belief that this issue should be addressed through greater disclosure and better corporate governance rather than new accounting standards. We are taking this opportunity to provide you with a paper selling out the Association's position on these proposals.

From the outset, we would like to make it clear that, as an Association dedicated to the promotion of employee financial involvement, including share ownership, we believe that this proposal will have a negative impact on the willingness of employers to introduce new schemes and or relaunch current schemes which may have an annual invitation or grant date.

We would welcome the opportunity to engage in further dialogue with you regarding this issue. If you would like to discuss any aspect of our submission please do not hesitate to contact, in the first instance, Maureen Brogan, on 01-6051644

Yours sincerely

Jim Ryan

Jim Ryan
Chair- IPSA Accounting Sub-committee

Irish ProShare Association Confederation House 84-86 Lower Baggot Street Dublin 2
Telephone: (01) 605 1696/1643 Fax: (01) 638 1696/1643 E-mail: ipsa@ibec.ie Website: www.ibec.ie/ipsa

IPSA Position on Proposed New Accounting Rules for Share-Based Payments

The IPSA

The Irish ProShare Association (IPSA) is an independent national association affiliated to IBEC. It is engaged in promoting the concept of Employee Financial Involvement (EFI) and its various forms. For the past 20 years the IPSA has actively promoted the development of EFI including profit sharing, gainsharing and employee share ownership schemes. The IPSA also lobbies to encourage a tax and legislative environment, which supports the development of EFI and makes representations to national and international stakeholders for the promotion of EFI.

Proposed new accounting standards

On 7 November 2002, the International Accounting Standards Board (IASB) published a draft of a new accounting standard on share-based payments. On the same day the Accounting Standards Board (A SB) published Financial Reporting Exposure Draft (FRED) 31 'Sharebased Payment'. The FRED presents proposals for an accounting standard based on the International Accounting Standards Board's (IASB' s) exposure draft, ED 2. In the FRED the ASB proposes that the IASB's standard should be adopted in the UK and Ireland.

FRED 31 proposes that the standard should apply to all Irish/UK entities—both listed and unlisted—and to all share-based payment transactions, including all employee share option schemes, all Save-As-You-Earn (SAYE) plans and similar arrangements, and all share-based payment transactions involving the receipt of goods and non-employee services.

According to the ASB, the draft standard is based on the following principles:

- When an entity receives goods or other services in exchange for a share-based payment, it should recognise an expense.
- That expense should be recognised over the period in which the services involved are rendered or as the goods involved are received.
- The expense should be measured by reference to fair value.

The Irish ProShare Association, February 2003

Impact of proposed new standards

If adopted, the proposed new standard will require companies to expense in their accounts a cost of awarding shares and granting share options to their executives and employees. This standard will apply to all companies irrespective of size or type of employee share scheme in place. If the European Commission endorses this new standard, every company listed on a regulated market in the EU will be required to follow it from 2005 onwards.

IPSA's concern

While IPSA supports the principle of international accounting standards, this proposal and the consequences of its adoption is of major concern to the group. According to Pro-Share UK, a survey it carried out shows that 40%of companies will change their all-employee plans and many will stop their plans all together, because of the adverse effect that these proposals would have on the calculation of operating profits etc. (see comments below). There are also concerns regarding increased accounting cost, compliance costs and the need to put in place procedures and systems to track employees.

With this type of evidence, it is clear that there is good reason for the concern that adoption of the proposed new rules will have the effect of discouraging the use of employee share plans. It would be an extremely unfortunate consequence if this were to be the case. Employee Share Schemes have been very significant across the EU in encouraging regular saving and investing by employees. This, in turn, has resulted in substantial transfers of wealth to employees. Indeed, for many employees, these plans have made a significant difference in their quality of life, being used to finance such things as repaying their mortgage or sending their children to university.

While the potential rewards of Employee Share Schemes are clearly appealing to employees, the link to performance and their ability to promote a common interest between employees and management make such arrangements increasingly attractive to employers. Employers often view share schemes as tools to incentivise and motivate employees and indeed, they are generally credited for aiding employee commitment and loyalty.

Current Practice

UITF 17 requires stock compensation expense to be charged to the profit and loss account to the extent that there is a difference between the market value of the share at date of grant and option price.

The UITF states that the credit entry should go to reserves but does not say what reserve. Therefore while current practice effects operating profits, it may not effect the distributable reserves of the company, if the current entry is made to retained reserves.

FRED 31

When an entity receives good/services and payment is in the form of an equity settled share based transaction, the proposed standard is of the opinion that an equity instrument is issued on the grant date and the fair value of that instrument on that date will equal the fair value of the goods or services that are expected to be received at the grant date.

In the case of a share option scheme used to remunerate employees, the fair value of the services received would be charged as an expense to the profit and loss account, with a corresponding credit entry to the equity capital of the entity. As the stock compensation is a notional entry, the reserve into which it is credited should be realised such that the distributable reserves are maintained.

IPSA's position

A transparent reporting of a particular transaction is one that gives a faithful representation of the underlying economic effect of the transaction on the reporting entity. We are not aware of any valid evidence that the grant of an employee stock option constitutes an economic cost to the granting entity. When an employee stock option is granted, there is no outflow of assets or a decline in asset value as a result of the stock option grant. Inputing an expense into the income statement would imply that there is an economic cost (i.e. an incremental cash outflow required) when no such cost (i.e. no outflow) has or will occur. The true economic cost of a stock option transaction is already reflected in current financial reports via the earnings per share disclosure

As far as the issue of 'fair value' is concerned the requirement to use an option pricing model to measure the value of an employee stock option will result in highly subjective and potentially unreliable data being recognised in the income statement. The subjectivity of assumptions used in option pricing models will yield diversity in application from one company to the next, thereby, impairing comparability and confusing the users of financial statements.

The Irish ProShare Association, February 2003

Summary

Current accounting for stock compensation expense affects operating profit, but does not affect distributable reserves.

The measurement of stock compensation under FRED 31 is based on fair value, calculated by reference to an option pricing model. Hence, stock compensation expense is likely to be higher when calculated on fair values. FRED 31 accounting will reduce operating profits, and should be interpreted in a manner so as not to affect distributable reserves.

Earnings per share (EPS) is currently calculated by reference to profit after tax. Any adverse effect on operating profit will therefore have an adverse effect on earnings per share. EPS is an important performance indicator, in the market place. An adverse effect on EPS caused by stock compensation expense, could potentially have a negative impact on the market price of a share, unless it is adjusted for by analysts when they are assessing companies' performance.

Conclusion

According to the IASB, the objective of the proposal is to ensure that entities recognise share-based payment transactions in their financial statements, so as to provide high quality, transparent and comparable information to users of financial statements. The body also states that the proposal has been developed in the context of increasing take up by companies of Employee Share Schemes. The irony of this situation is that the very proposal that has been driven by increased use of schemes is very likely to lead to an actual downturn in their use.

The IPSA's view is that the concerns that surround employee share schemes relate to executive schemes only and should be addressed through greater disclosure and better corporate governance rather than new accounting rules. It does not support the proposed new standard because, ultimately, it will have a detrimental effect upon the take up of Employee Share Ownership Schemes.