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PROSHARE

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Ms Kimberley Crook
Project Manager
International Accounting Standards Board
30 Cannon Street
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Dear Kimberley,

ED2 "SHARE-BASED PAYMENT"

I enclose ProShare's response to the IASB's Exposure Draft ED2 on Share-Based Payment. We welcome this opportunity to comment.

Our response consists of a paper on the Application of ED2 to All-Employee Share Plans and our answers to the IASB's Questions on ED2.

As an organisation that represents the interests of the private investor we want accounting standards to provide high quality, transparent and comparable information to all users of financial statements. We also want to see convergence of accounting standards and therefore welcome the work that is being done to bring about a level playing field between Europe and the United States in this respect.

ProShare also promotes employee share ownership. Our focus is primarily on broad- based or all-employee share plans. While not a trade body, we also speak for the UK companies that have embraced broad-based share ownership and the employees that participate in it.

We believe that all-employee plans are fundamentally different from executive options and other selective plans. The special characteristics of all-employee plans together with their underlying objectives of involvement and participation put them apart from other share plans and from share-based payments generally. Consequently, we believe they are an exception to the general presumption underlying ED2, that all share plans are for the purpose of supplying goods or services to an entity.

In brief, we believe it is mistaken to see these plans as provided in return for services and as part of the pay package. There are critical differences between all-employee plans, on the one hand, and the selective option plans and executive options, on the other, that have so dominated the recent headlines and corporate governance debate. We explain what these differences are and why all-employee plans should be treated differently in the attached paper. All-employee share plans are not about mega options and corporate greed, they are about small amounts of shares and options going to every employee at every level in the company who wants to participate in the ownership of that company.

We are very concerned that the effect of ED2 will be to damage seriously the positive development of wider share ownership achieved through financial participation. Discussing this with companies over recent weeks confirms our fears that if existing plans continue they will be scaled back and reduced. Some will stop altogether. More worrying however is the fact that ED2 creates a barrier and will deter companies new to financial participation from ever putting in plan. This is at a time when the UK Government is seeking to double the number of companies with an all-employee plan and the European Commission is appealing to Member States to promote financial participation in the EU by improving the conditions for this in their country.

Many companies and other organisations support this view. We already know that bodies such as the British Banker's Association are in support of an exemption for all-employee plans and the TUC have gone on record to say that all-employee plans are very different from executive share options. It has cross-party political support in the UK, with currently two Early Day Motions registering concern over the impact of ED2 if applied to all-employee plans.

The issue of convergence with the US is of critical importance. We want a standard on share-based payment that applies worldwide. This must however apply across the board. At present the equivalent US accounting standards exclude certain share purchase plans and ESOPs. For there to be genuine convergence, the treatment of all-employee plans is key. The IASB and FASB must agree on a common approach.

We believe that the US approach is right, even if their criteria may not be satisfactory. In our paper we set out the way a robust principled-based definition of an all-employee plan could be achieved. We would be happy to work with the IASB on this.

We therefore strongly urge the IASB to reconsider carefully the arguments that we and others have put forward and to exclude all-employee plans from the final IFRS.

Yours sincerely

Diane Hay
Chief Executive
ProShare (UK) Ltd

IASB Invitation to Comment on ED2 Share-Based Payment

ProShare's Response

Question 1

Paragraphs 1-3 of the draft IFRS set out the proposed scope of the IFRS. There are no proposed exemptions, apart from for transactions within the scope of another IFRS. Is the proposed scope appropriate? If not, which transactions should be excluded and why?

A. In our view the presumption underlying ED2 - that all share plans resulting in the award of shares or the grant of options to employees or others are evidence that the entity has engaged in a transaction in which it has received resources in the form of goods or services as consideration for the issue of those shares or options - is not of universal application. In particular we do not think that it applies in the case of all-employee share plans. A separate paper is attached setting out the reasons why we believe that all-employee plans need to be given separate consideration.

As users of accounts focus exclusively on consolidated company accounts, it seems to us that requiring an expense to be charged in subsidiary company accounts is a further complication and an unnecessary one. We therefore think that the IASB should consider whether to exclude the requirements in respect of any individual accounts where consolidated accounts are prepared.

The IASB should also consider whether unlisted companies should be excluded from any new IFRS as making any estimate of the volatility of unlisted companies is exceeding difficult – as recognised in the US where this factor is taken to be zero. This would not disadvantage users given that the charge would be unreliable.

Question 2

Paragraphs 4-6 of the draft IFRS propose requirements for the recognition of share-based payment transactions, including the recognition of an expense when the goods or services received or acquired are consumed. Are these recognition requirements appropriate? If not, why not, or in which circumstances are the recognition requirements inappropriate?

A. If goods and services are consumed, we agree that an expense falls to be recognised, as required by the conceptual framework. However, it should be assumed, without evidence, that goods and services are received when share are

awarded or a share option is granted. In some circumstances this may be the case, but in others it may not. The accounting treatment should reflect the facts and evidence of the receipt of goods and services should therefore be sought.

In terms of the timing of recognition, it is necessary to identify the time when the goods and services are consumed. This can only be done once it has been clearly established that there is a connection between the grant of the option and the consumption of the goods and services.

Question 3

For an equity-settled share-based payment transaction, the draft IFRS proposes that, in principle, the entity should measure the goods or services received, and the corresponding increase in equity, either directly, at the fair value of the goods or services received, or indirectly, by reference to the fair value of the equity instruments granted, whichever fair value is more readily determinable (paragraph 7). There are no exemptions to the requirement to measure share-based payment transactions at fair value. For example, there are no exemptions for unlisted entities. Is this measurement principle appropriate? If not, why not, or in which circumstances is it not appropriate?

A. We think that the measurement principle is appropriate.

We think the IASB should consider an exemption for unlisted companies given the unreliability of an approach based on estimating the fair value of the equity instrument.

Question 4

If the fair value of the goods or services received in an equity-settled share-based payment transaction is measured directly, the draft IFRS proposes that fair value should be measured at the date when the entity obtains the goods or receives the services (paragraph 8). Do you agree that this is the appropriate date at which to measure the fair value of the goods or services received? If not, at which date should the fair value of the goods or services received be measured? Why?

A. We agree that the date of receipt is appropriate.

Question 5

If the fair value of the goods or services received in an equity-settled share-based payment transaction is measured by reference to the fair value of the equity instruments granted, the draft IFRS proposes that the fair value of the equity instruments granted should be measured at grant date (paragraph 8). Do you agree that this is the appropriate date at which to measure the fair value of the equity instruments granted? If not, at which date should the fair value of the equity instruments granted be measured? Why?

A. ***In our response to the last consultation we stated that grant date, compared to vesting date, was the appropriate date because this is the date on which legal obligations come into existence. Since then the issue has become more problematic, particularly given the complexity of the calculation of the expense under a grant-based approach. Many companies are now concerned about the compliance cost of calculating the charge at grant and that there will be no adjustment made for lapsed options or forfeited shares. This is exacerbated by the interaction of accounting rules with tax rules based on exercise rather than grant, which will cause particular problems for UK companies.***

Question 6

For equity-settled transactions with parties other than employees, the draft IFRS proposes a rebuttable presumption that the fair value of the goods or services received is more readily determinable than the fair value of the equity instruments granted (paragraphs 9 and 10). Do you agree that the fair value of the goods or services received is usually more readily determinable than the fair value of the equity instruments granted? In what circumstances is this not so?

A. ***We agree that this is usually the case. However, please also see our answer to Question7 below.***

Question 7

For equity-settled transactions with employees, the draft IFRS proposes that the entity should measure the fair value of the employee services received by reference to the fair value of the equity instruments granted, because the latter fair value is more readily determinable (paragraphs 11 and 12).

Do you agree that the fair value of the equity instruments granted is more readily determinable than the fair value of the employee services received? Are there any circumstances in which this is not so?

A. ***We think that the IASB's decision that accounting for the cost of services received from employees can only be represented by the fair value of the equity instrument transferred to them and not by the value of those services is too restrictive. According to paragraph BC62-63, this is because of the practical difficulties in measuring the fair value of the services directly as "typically shares or options are granted to employees as one component of their pay package". Firstly we do not think applies in all cases, particularly in the case of all-employee share plans.***

Secondly, there are occasions when share-based payments are made under a contractual agreement with an employee. In these cases, there may well be occasions when the fair value of employee services is ascertainable. In those circumstances, we think that the fair value of those services should be used instead and should not be automatically replaced by an indirect valuation based on the fair value of the equity instrument granted.

We think that, whether these are transactions with employees or with third parties, an entity should be permitted to value either the equity instruments granted or the value of services or goods received, whichever is most appropriate in the particular circumstances. For example, one employee may have a contract for services where the only reward is in the form of shares whereby another employee with identical duties may work solely for cash. In this case the amount of cash could well be the value of the services. In other cases, the value of the services provided under a contract that includes the award of shares may be more difficult to measure, in which case it might be argued that a fair value of the equity instruments granted would be more appropriate.

Question 8

Paragraphs 13 and 14 of the draft IFRS propose requirements for determining when the counterparty renders service for the equity instruments granted, based on whether the counterparty is required to complete a specified period of service before the equity instruments vest.

Do you agree that it is reasonable to presume that the services rendered by the counterparty as consideration for the equity instruments are received during the vesting period? If not, when are the services received, in your view?

A. If an employee has a contractual arrangement to render services in return for shares or options, then it might be reasonable to presume that the services are rendered during the vesting period.

However, not all employees render services in return for shares. This would not be the case, for example, in many all-employee free share plans and where shares are gifted to employees by founding family shareholders and held in trust for them.

Question 9

If the services received are measured by using the fair value of the equity instruments granted as a surrogate measure, the draft IFRS proposes that the entity should determine the amount to attribute to each unit of service received, by dividing the fair value of the equity instruments granted by the number of units of service expected to be received during the vesting period (paragraph 15).

Do you agree that if the fair value of the equity instruments granted is used as a surrogate measure of the fair value of the services received, it is necessary to determine the amount to attribute to each unit of service received? If not, what alternative approach do you propose? If an entity is required to determine the amount to attribute to each unit of service received, do you agree that this should be calculated by dividing the fair value of the equity instruments granted by the number of units of services expected to be received during the vesting period? If not, what alternative methods do you propose?

A. ***We are concerned about the practical administration of the requirements set out in ED2 for calculating the charge. The amount of record keeping needed and creation of software and systems to support this, in order to produce the required figures is likely to be substantial. We doubt that such an elaborate methodology is necessary given the unreliability of many of the assumptions and estimates that will be used to compute the fair value of the equity instrument.***

The complexity arises in part from the requirement to true up the result to reflect the actual services received. One option therefore would be to drop the requirement to adjust the charge against profits for the numbers of units of service actually received. It could be argued that the extra accuracy in resulting from truing up to actual is unlikely to be material in the vast majority of cases as the staff turnover expectation will be rebased each year as new grants are made.

Another alternative would be to adopt the much more simplified approach suggested by EFRAG that would base the charge on a straight–line comparison between actual numbers of staff at the year-end.

In our view this area of the proposals would benefit greatly from further consideration by the IASB. We think the IASB has not fully appreciated the burden that their proposed approach will place on companies and it should field-test this and alternative approaches before requiring them to be a mandatory part of any IFRS.

Question 10

In an equity-settled share-based payment transaction, the draft IFRS proposes that having recognised the services received, and a corresponding increase in equity, the entity should make no subsequent adjustment to total equity, even if the equity instruments granted do not vest or, in the case of options, the options are not exercised (paragraph 16). However, this requirement does not preclude the entity from recognising a transfer within equity, i.e. a transfer from one component of equity to another.

Do you agree with this proposed requirement? If not, in what circumstances should an adjustment be made to total equity and why?

A. ***Where options are granted over new issue shares, so that the exercise of an option will result in the increase of the company's share capital, we would expect the accounts to show an increase in equity. However, where options are granted over existing shares, so that the exercise of an option simply results in the transfer of shares from an existing shareholder to the exercising optionholder, under ED2 there is an increase in equity even though the number of shares in existence remains the same both before and after the exercise of the option. The exposure draft should be expanded to deal with this point in more detail.***

The approach adopted by the IASB is likely to lead over time to the accumulation of significant reserves on the balance sheet. If these reserves can be transferred and somehow released that may help. More guidance is required on how this could be achieved – but we accept that this is a matter of national and EU company law.

Again we do not think this aspect of ED2 has been sufficiently thought through and would benefit from further consideration. For example, we suggest that, as there will never be a cash outflow as a result of the transaction, there should be a transfer from 'shares to be issued' to 'distributable profits', such that the accounting required by the IFRS does not decrease distributable profits. This is a vital matter to many companies with very real consequences for their businesses.

Question 11

The draft IFRS proposes that the entity should measure the fair value of equity instruments granted, based on market prices if available, taking into account the terms and conditions of the grant (paragraph 17). In the absence of a market price, the draft IFRS proposes that the entity should estimate the fair value of options granted, by applying an option pricing model that takes into account various factors, namely the exercise price of the option, the life of the option, the current price of the underlying shares, the expected volatility of the share price, the dividends expected on the shares (where appropriate) and the risk-free interest rate for the life of the option (paragraph 20). Paragraph 23 of the proposed IFRS explains when it is appropriate to take into account expected dividends.

Do you agree that an option pricing model should be applied to estimate the fair value of options granted? If not, by what other means should the fair value of the options be estimated? Are there circumstances in which it would be inappropriate or impracticable to take into account any of the factors listed above in applying an option pricing model?

A. As far as we are aware, if the entity has to arrive at the fair value of the option, that reflects the intrinsic and time value of the option, it will have to apply an option pricing model.

However, we remain concerned that these models will not produce a reliable measure as they were designed to value short-dated traded options and not employee options. While we understand the arguments made by the IASB in paragraphs BC 278 – 294, we understand that the model's inaccuracy increases significantly in the case of options issued "at the money"(as most employee options are) and this inaccuracy is compounded when the period before the option can be exercised stretches over several years.

We referred to the problems faced by unlisted companies in our answers to Questions 1 and 3. If they are required to use an option pricing model the IASB should consider allowing them to set the volatility factor at zero, as is the case under FSAS 123. The suggestion made in paragraph IG17 that more than 30 price observations may be needed in the case of a long-dated option is daunting for many unlisted companies that value their shares only once or twice a year.

Question 12

If an option is non-transferable, the draft IFRS proposes that the expected life of an option rather than its contracted life should be used in applying an option pricing model (paragraph 21). The draft IFRS also proposes requirements for options that are subject to vesting conditions and therefore cannot be exercised during the vesting period (paragraph 22).

Do you agree that replacing an option's contracted life with its expected life when applying an option pricing model is an appropriate means of adjusting the option's fair value for the effects of non-transferability? If not, do you have an alternative suggestion? Is the proposed requirement for taking into account the inability to exercise an option during the vesting period appropriate?

A. The ability to transfer an option allows the option holder to crystallise in the sales proceeds both the intrinsic value and remaining time value of the option. On average, therefore, we accept that using the expected life rather than the full life to value the option at the outset reflects the loss of time value that an employee experiences when he or she is obliged to exercise rather than sell their options to someone else.

However, we observe that this adjustment is wholly separate from any adjustment to value that relates to an employee's inability to exercise an option during the option vesting period. As an example, an option that is fully transferable may be granted that is subject to a vesting period which continues

after transfer. The value of that option will be less than a fully transferable option without a vesting period. This is because the option holder is denied access to the option gain during the vesting period.

Question 13

If a grant of shares or options is conditional upon satisfying specified vesting conditions, the draft IFRS proposes that these conditions should be taken into account when an entity measures the fair value of the shares or options granted. In the case of options, vesting conditions should be taken into account either by incorporating them into the application of an option pricing model or by making an appropriate adjustment to the value produced by such a model (paragraph 24).

Do you agree that vesting conditions should be taken into account when estimating the fair value of options or shares granted? If not, why not? Do you have any suggestions for how vesting conditions should be taken into account when estimating the fair value of shares or options granted?

A. We agree that vesting conditions should be taken into account when estimating a fair value of options or shares granted.

The adjustment to arrive at fair value should reflect:

- ***The option holder's inability to access the option gain during the vesting period (for non-transferable options); and***
- ***The risk of forfeiture for not meeting the vesting conditions including:***
    - ***An assessment of the risk of forfeiture due to staff turnover (this should be measured over the period from grant to the later of either the date of remaining in service specified or the date on which any other (perhaps financial) performance conditions are attained);***
    - ***The probability that the option will lapse unexercised (or become unexerciseable) due to the operation of any exercise conditions; and***
    - ***The probability that any conditions may be waived or varied during the option's life if this can be assessed with any reliability.***

Any IFRS should make it clear that the combined probability (recognising interdependencies) of meeting performance conditions governing vesting should reflect both the performance standard (how high the hurdle is set) and the basis on which testing is conducted. For example, some tests are rolling tests over a period of 3 years and therefore the start point for measurement needs to be re-based on each test: whereas others apply over extended periods. Similarly, some share plans provide for multiple tests, and some only provide for one test.

Question 14

For options with a reload feature, the draft IFRS proposes that the reload feature should be taken into account, where practicable, when an entity measures the fair value of the options granted. However, if the reload feature is not taken into account in the measurement of the fair value of the options granted, then the reload option granted should be accounted for as a new option grant (paragraph 25).

Is this proposed requirement appropriate? If not, why not? Do you have an alternative proposal for dealing with options with reload features?

A. ***We have no strong views regarding the treatment of options of reload features, as these are very rare in the UK.***

Question 15

The draft IFRS proposes requirements for taking into account various features common to employee share options, such as non- transferability, inability to exercise the option during the vesting period, and vesting conditions (paragraphs 21- 25).

Are there other common features of employee share options for which the IFRS should specify requirements?

A. ***Many share plans contain provisions that may accelerate vesting in the event of a change in the control of the entity or in the case of compassionate leavers (when employees leave before the end of a vesting period due to sickness, redundancy etc).***

However, to require an entity to make adjustments for these features would add further complexity and an extra burden. Entities might however wish to adjust for compassionate leavers if a reliable estimate can be made and should be allowed to do so.

Question 16

The draft IFRS does not contain prescriptive guidance on the estimation of the fair value of options, consistently with the Board's objective of setting principles-based standards and to allow for future developments in valuation methodologies.

Do you agree with this approach? Are there specific aspects of valuing options for which such guidance should be given?

A. ***We agree with the objective of setting principle-based standards but this should be accompanied by non-prescriptive guidance.***

Question 17

If an entity re-prices a share option, or otherwise modifies the terms or conditions on which equity instruments were granted, the draft IFRS proposes that the entity should measure the incremental value granted upon repricing, and include that incremental value when measuring the services received. This means that the entity is required to recognise additional amounts for services received during the remainder of the vesting period, ie additional to the amounts recognised in respect of the original option grant. Example 3 in Appendix B illustrates this requirement. As shown in that example, the incremental value granted on repricing is treated as a new option grant, in addition to the original option grant. An alternative approach is also illustrated, whereby the two grants are averaged and spread over the remainder of the vesting period.

Do you agree that the incremental value granted should be taken into account when measuring the services received, resulting in the recognition of additional amounts in the remainder of the vesting period? If not, how do you suggest repricing should be dealt with? Of the two methods illustrated in Example 3, which is more appropriate? Why?

A. Please see our answer to Question 18

Question 18

If an entity cancels a share or option grant during the vesting period (other than a grant cancelled by forfeiture when the vesting conditions are not satisfied), the draft IFRS proposes that the entity should continue to recognise the services rendered by the counterparty in the remainder of the vesting period, as if that grant had not been cancelled. The draft IFRS also proposes requirements for dealing with any payment made on cancellation and/or a grant of replacement options, and for the repurchase of vested equity instruments. Are the proposed requirements appropriate? If not, please explain why not and provide details of your suggested alternative approach.

A. We do not agree with the accounting set out in paragraph 29(a) and (c). When an option is cancelled it is clear no further services are to be provided in respect of it. It is therefore confusing to continue to recognise an expense in relation to it. Replacement options should be accounted for as new options and, as repricing of existing options is economically the same, the accounting should also be the same.

Question 19

For cash-settled share-based payment transactions, the draft IFRS proposes that the entity should measure the goods or services acquired and the liability incurred at the fair value of the liability. Until the liability is settled, the entity should remeasure the fair value of the liability at each reporting date, with any changes in value recognised in the income statement.

Are the proposed requirements appropriate? If not, please provide details of your suggested alternative approach.

A. We think that, in the interests of simplicity of financial statements, the accounting treatment should follow that for a true cash liability, ie recognise only the intrinsic value as a liability at the balance sheet date (particularly bearing in mind the extra accuracy likely to be obtained is marginal as the total liability to be recognised is the same, just spread over different accounting periods).

Question 20

For share-based payment transactions in which either the entity or the supplier of goods or services may choose whether the entity settles the transaction in cash or by issuing equity instruments, the draft IFRS proposes that the entity should account for the transaction, or the components of that transaction, as a cash-settled share-based payment transaction if the entity has incurred a liability to settle in cash, or as an equity-settled share-based payment transaction if no such liability has been incurred. The draft IFRS proposes various requirements to apply this principle.

Are the proposed requirements appropriate? If not, please provide details of your suggested alternative approach.

A. We agree with the suggested approach – subject to our concerns on cash-based settlement mentioned in our answer to Question 19.

Question 21

The draft IFRS proposes that an entity should disclose information to enable users of financial statements to understand:

(a) the nature and extent of share-based payment arrangements that existed during the period,

(b) how the fair value of the goods or services received, or the fair value of the equity instruments granted, during the period was determined, and

(c) the effect of expenses arising from share-based payment transactions on the entity's profit or loss.

Are these disclosure requirements appropriate? If not, which disclosure requirements do you suggest should be added, deleted or amended (and how)?

A. ***We agree that good disclosure is appropriate in this area in order for users of accounts to understand the potential impact of share plans and it therefore follows that we agree with the sentiment expressed in question 21. We would welcome guidance in disclosure regarding the types of share plans and the nature of their performance conditions in order that users of accounts can better understand the link between equity based pay arrangements and performance.***

However, if there is an accounting charge as well as disclosure we think that the disclosure requirements set out in paragraph 45 to 53 of ED2 are excessive and should be simplified and reduced. For example the need to information required under paragraphs 48 (b) and (c) will run to many pages in the case of a company that is rolling out a share plan across a large number of countries each with a different start date. We doubt whether users of accounts need to know, or are interested in, such extensive details of every different share plan that a company has in place.

We also feel strongly that any matter that might be regarded as price sensitive should not be made subject to disclosure. In particular, the expected dividend and vesting condition disclosures in paragraphs 48(a) (i) and 48(a) (iv) respectively are effectively profit forecasts.

Furthermore, we suggest that the disclosure requirements are mandated to be in a prescribed tabular format provided under the IFRS. In this way, preparers of accounts can easily check their disclosure compliance and users of accounts can readily find the relevant information.

Question 22

The draft IFRS proposes that an entity should apply the requirements of the IFRS to grants of equity instruments that were granted after the publication date of this Exposure Draft and had not vested at the effective date of the IFRS. It also proposes that an entity should apply retrospectively the requirements of the IFRS to liabilities existing at the effective date of the IFRS, except that the entity is not required to measure vested share appreciation rights (and similar liabilities) at fair value, but instead should measure such liabilities at their settlement amount (ie the amount that would have been paid on settlement of the liability had the counterparty demanded settlement at the date the liability is measured).

Are the proposed requirements appropriate? If not, please provide details of your suggestions for the IFRS's transitional provisions.

A. While we understand that some companies would want full retrospection, others would prefer full prospective application ie to grants or awards made on or after the date that any IFRS comes into force. We therefore think that companies should be able to select whatever transition they think appropriate.

Moreover, while we accept that the proposal that any IFRS should apply to all options granted or shares awarded after 7 November 2002 was intended to provide certainty, we think that the starting date should be delayed until the day that the IFRS comes into effect. Following the publication of a new standard, companies may well have to take another fundamental look at the design of their share plans and service providers may well have to make significant amendments to their prototype systems.

It is also unsatisfactory that there are different transitional rules for cash-settled transactions. Many global share plans will settle in both cash and equities, depending on the host country's attitude to its nationals owning shares in a foreign entity. Requiring different transitions rules will add complexity and cost.

Question 23

The draft IFRS proposes a consequential amendment to IAS 12 (revised 2000) Income Taxes to add an example to that standard illustrating how to account for the tax effects of share- based payment transactions. As shown in that example, it is proposed that all tax effects of share-based payment transactions should be recognised in the income statement.

Are the proposed requirements appropriate?

A. We have no strong views on the proposed requirements.

Question 24

In developing the Exposure Draft, the Board considered how various issues are dealt with under the US standard SFAS 123 Accounting for Stock- Based Compensation, as explained further in the Basis for Conclusions. Although the draft IFRS is similar to SFAS 123 in many respects, there are some differences. The main differences include the following.

(a) Apart from transactions within the scope of another IFRS, the draft IFRS does not propose any exemptions, either from the requirement to apply the IFRS or from the requirement to measure share-based payment transactions at fair value. SFAS 123 contains the following exemptions, none of which are included in the draft IFRS:

- employee share purchase plans are excluded from SFAS 123, provided specified criteria are met, such as the discount given to employees is relatively small;
- SFAS 123 encourages, but does not require, entities to apply its fair value measurement method to recognise transactions with employees; entities are permitted to apply instead the intrinsic value measurement method in

Accounting Principles Board Opinion No. 25 Accounting for Stock Issued to Employees (paragraphs BC70- BC74 in the Basis for Conclusions give an explanation of intrinsic value); and

- unlisted (non- public) entities are permitted to apply the minimum value method when estimating the value of share options, which excludes from the valuation the effects of expected share price volatility (paragraphs BC75- BC78 in the Basis for Conclusions give an explanation of minimum value).

A. We believe that SFAS 123 is correct in treating these broad-based plans differently. Please see our separate paper on all-employee share plans.

We think that unlisted companies should be allowed to ignore volatility.

(b) For transactions in which equity instruments are granted to employees, both SFAS 123 and the draft IFRS have a measurement method that is based on the fair value of those equity instruments at grant date. However:

under SFAS 123, the estimate of the fair value of an equity instrument at grant date is not reduced for the possibility of forfeiture due to failure to satisfy the vesting conditions, whereas the draft IFRS proposes that the possibility of forfeiture should be taken into account in making such an estimate.

under SFAS 123, the transaction is measured at the fair value of the equity instruments issued. Because equity instruments are not regarded as issued until any specified vesting conditions have been satisfied, the transaction amount is ultimately measured at the number of vested equity instruments multiplied by the fair value of those equity instruments at grant date. Hence, any amounts recognised for employee services received during the vesting period will be subsequently reversed if the equity instruments granted are forfeited. Under the draft IFRS, the transaction is measured at the deemed fair value of the employee services received. The fair value of the equity instruments granted is used as a surrogate measure, to determine the deemed fair value of each unit of employee service received. The transaction amount is ultimately measured at the number of units of service received during the vesting period multiplied by the deemed fair value per unit of service. Hence, any amounts recognised for employee services received are not subsequently reversed, even if the equity instruments granted are forfeited.

A. Under the proposed IFRS the value of services received and consumed will not be reversed out even if the equity instrument (which was offered in exchange) lapses. However, this approach creates a major difference between IAS standards and SFAS 123. We find it difficult to say which basis of measurement is "right" – as it appears do many contributors to the option accounting debate. We therefore think that the IASB and FASB need to reconcile this fundamental difference in approach before any new IFRS is introduced.

Failure to reach agreement on this point would jeopardise the steps being taken to achieve convergence.

(c) If, during the vesting period, an entity settles in cash a grant of equity instruments, under SFAS 123 those equity instruments are regarded as having immediately vested, and therefore the amount of compensation expense measured at grant date but not yet recognised is recognised immediately at the date of settlement. The draft IFRS does not require immediate recognition of an expense but instead proposes that the entity should continue to recognise the services received (and hence the resulting expense) over the remainder of the vesting period, as if that grant of equity instruments had not been cancelled.

A. We agree with the approach taken in SFAS 123. Where an equity instrument obligation is cancelled by a payment of cash, the cash should be a charge against profit and loss account as, first, the cash represents a real economic outflow from the entity and, second, the arrangement is at an end. To argue that the employees are continuing to provide services beyond that point in respect of it is illogical.

(d) SFAS 123 does not specify a measurement date for transactions with parties other than employees that are measured at the fair value of the equity instruments issued. Emerging Issues Task Force Issue 96-18 Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services requires the fair value of the equity instruments issued to be measured at the earlier of (i) the date a performance commitment is reached or (ii) the date performance is complete. This date might be later than grant date, for example, if there is no performance commitment at grant date. Under the draft IFRS, the fair value of the equity instruments granted is measured at grant date in all cases.

A. We agree with SFAS 123.

(e) SFAS 123 requires liabilities for cash-settled share appreciation rights (SARs) to be measured using an intrinsic value measurement method. The draft IFRS proposes that such liabilities should be measured using a fair value measurement method, which includes the time value of the SARs, in the same way that options have time value (refer to paragraphs BC70- BC81 of the Basis for Conclusions for a discussion of intrinsic value, time value and fair value).

A. We agree with SFAS 123 and believe that liabilities which are cash settled should be recognised at their intrinsic value not their full theoretical fair value (for the reasons given in answer to Question 19).

(f) For a share-based payment transaction in which equity instruments are granted, SFAS 123 requires realised tax benefits to be credited direct to equity as additional paid- in capital, to the extent that those tax benefits exceed the tax benefits on the total amount of compensation expense recognised in respect of that grant of equity instruments. The draft IFRS, in a consequential amendment to IAS 12 (revised 2000) Income Taxes, proposes that all tax effects of share- based payment transactions should be recognised in profit or loss, as part of tax expense.

A. We do not hold strong views on this aspect.

Question 25

Do you have any other comments on the Exposure Draft?

A. Please see our covering letter. In addition, items where further consideration and guidance is required include the treatment of the entries required in respect of the issue, cancellation and movement between equity, and how these are affected when the share-based payment comes from new issue shares as compared to existing shares.

PROSHARE

APPLICATION OF ED2 TO ALL-EMPLOYEE SHARE PLANS

Introduction

1. Financial participation - the involvement of employees in the profits and ownership of enterprise – has been widely recognised as a potentially major contributor to key economic and social goals. It takes many forms, but there are four broad classifications:
    - Share purchase, sometimes at a discount, and/or with the addition of free "matched" shares
    - Free shares, which may be subject to forfeiture
    - Share options, again sometimes at a discount, which can be exercised and the shares sold or retained
    - Profit-sharing, which provides employees with a variable income linked to the enterprise's profits.

    "Employee share ownership" is usually taken to cover all forms of share-based financial participation, ie excluding profit-sharing unless distributed as free shares .

2. Again, in broad terms, employee share ownership plans fall into two distinct types. There are those in which participation is open and there are others in which participation is restricted. The former are commonly referred to as "all-employee" or broad-based share plans. The latter are often referred to as "selective" plans. These are more diverse in nature and would range from share options plans for individual or groups of managers to one-off arrangements for senior executives.

3. Within Europe, broad-based financial participation is an important issue for EU institutions, Social Partners and the Member State governments. Community policy on financial participation goes back to the Social Action Programme of 1989 and has been covered in two major reports, known as Pepper[1] I (1991) and Pepper II (1997) and a recent Commission Communication (2002). In the Communication the Commission has launched an appeal to Member State governments to improve conditions for the financial participation of workers in companies through share plans, share options or profit sharing.

[1] "Promotion of Employee Participation in Enterprise Results"

Relationship with Accounting Standards

4. The IAS Regulation passed by the Council in June 2002 requires all companies listed on a regulated market in the EU to prepare their consolidated accounts in accordance with International Accounting Standards (IAS) from 2005 onwards. Consequently the introduction of a new IAS on Share-Based Payment has a direct impact on employee share ownership and on financial participation generally throughout the EU.

5. Careful consideration therefore needs to be given as to whether the proposed IAS on Share-Based Payment is of general application to all forms of share-based financial participation. In particular there is the key question of whether it applies to all-employee or broad-based plans given the purpose and characteristics of these plans. This paper addresses this question.

Why do companies have share plans?

6. Share-based financial participation can be offered by an enterprise for a number of reasons. An enterprise will frequently have more than one form of financial participation in place, each serving different objectives. The objectives form a spectrum from creating true ownership of the business, as seen in the wholly owned employee enterprises, to making every employee a shareholder in the enterprise, to recruiting and retaining key talent in a start-up enterprise and to providing share performance–linked rewards to top executives of major companies.

7. Very frequently the objectives of all-employee and selective financial participation will be the same. An enterprise will operate a plan because they want to align the interests of all their employees with their shareholders. They want their employees, whether on the shop floor or boardroom, to identify with the goals and aims of the company they work for. They want the company to be more productive and successful and they philanthropically want to share the rewards of that success with their employees.

8. There is compelling evidence to support this view of why companies adopt financial participation plans. A survey undertaken for the EU Commission in 1999 by the Brussels-based Research Centre for Financial Participation looked at why the largest companies in the European Union implement financial participation plans. [2] These included both all-employee and selective plans. Of the 57 companies that participated in this survey 35% were located in the UK, 14% in Belgium, 14% in Germany, 12% in France and 9% in the Netherlands.

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[2] "A Company Perspective on Financial Participation in the European Union: Objectives and Obstacles" Prof. Francine Van den Bulcke, Research Centre for Financial Participation, Catholic University Brussels

9. These companies were asked to rate the importance of possible objectives for establishing financial participation plans. The three most important objectives for employers were:
   - To encourage employees to take a greater interest in the success of the company (78% of respondents)
   - To create a feeling amongst employees of belonging to one company and sharing common concern goals (55% of respondents)
   - To encourage greater alignment of employees' interests with those of shareholders (48% of respondents).

10. Also in 1999, ProShare carried out research into the existing UK tax-approved all-employee plans to discover why companies introduce these share plans[3]. Over 300 companies participated in this survey, 80% of which were quoted. The following three reasons were considered by companies as being the most important behind the introduction of all-employee share plans:

- To provide employees with a sense of involvement in the business (ranked top by 155 companies)
- To share the rewards of business success with employees (ranked top by 66 companies)
- To link employee and shareholder interests (ranked top by 36 companies).

11. What this survey also shows is that companies did not introduce all-employee plans to provide more tax-effective remuneration. While 155 and 69 companies respectively ranked providing employees with a sense of involvement in the business as their top two reasons for introducing a plan, only 8 companies ranked the provision of more tax-effective remuneration as their top objective.

12. Both surveys went on to measure to what extent these objectives were realised. The ProShare survey found that 83% of companies thought their share plans met or exceeded their objectives. Similarly, the European study found that participating companies believed that the key objectives were largely met.

13. These two surveys (undertaken well before the first Discussion Paper on Share-Based Payment was published) provide convincing evidence that companies introduce share plans with a view to increasing employees' sense of involvement and identification with the company. This is particularly true in the case of all-employee plans. There was very little evidence that these plans had been introduced to substitute for cash pay.

What makes all-employee plans so different?

14. An all-employee plan is different from a selective plan in a number of critical respects.

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[3] "Employee Share Schemes – Do They Create Employee Shareholders?" ProShare (UK) Ltd November 1999

15. **Offered to all employees –** This is perhaps the key feature that differentiates between an all-employee and a selective plan. The all-employee plan must to be offered to everyone in the company. The company cannot discriminate against any class of employee, whatever they do, whether they are full or part-time, on a permanent or fixed–term contract. The only exception is if the company sets a minimum service requirement before the employee can participate, but again, that must be the same for all employees. The company is free to do what it likes in a selective plan.

16. **Participation by the employee is entirely voluntary –** The employee is under no obligation to take part – he or she can decide whether to put their money into a share purchase plan or hold an option. They are even able to refuse the offer of free shares if they so wish, and some do.

17. **The opportunity to participate is made on "equal" or "similar" terms –** The extent to which an employee can participate is fixed. The plan will either be on "equal terms" – in which case, for example, everyone from the CEO down gets the same number of free shares or can apply for the same number of options. Alternatively some plans are offered on "similar terms" where the amount to which an employee can participate can vary but only by reference to objective factors such as length of service and salary. A manager has no discretion to offer an employee a greater or lesser amount of options or shares than that to which he is entitled under the terms of the plan. This would also apply to any bonus shares that the company could give to add to shares bought by the employee.

18. **The level of participation by the employee is decided by the employee –** It is entirely up to the employee how much they invest in the company's shares or how many options they subscribe for within the limits set by the terms of the plan

19. **The offer to participate in a plan is not part of a contractual agreement with the employee -** This is another critical difference between an all-employee plan and selective plans, especially one-off arrangements for senior executives. Contracts of employments will contain clauses to deal with selective plans and one-off arrangements but will not mention participation in all-employee plans. The company is under no contractual obligation to offer shares or options to its employees under an all-employee plan. Shares or options under an all-employee plan are not covered in TUPE Regulations – unlike pension schemes – apart from very rare cases where the company's conduct and a long history of regular awards might create an implied right. In the case of selective arrangements for senior executives, however, the award of shares or grant of options will be part of an individual contract for his or her services. If the contract is broken, the employee will usually have a right to sue for recompense for his entitlement to shares or options.

20. **It is up to the company to decide when and whether to offer an all-employee plan to their employees.** The company is under no obligation as regards either when or whether it will do that. The typical reasons why a company does not offer an all-employee plan – for example a new offer of SAYE – are either market conditions (a concern that because of the current share price there would be an adverse reaction to the plan from either employees or shareholders) or because a major change in the business is planned, usually a large-scale redundancy, or because of a breakdown in industrial relations.

21. In addition, a number of other characteristics are commonly found in all-employee plans.

22. **There are restrictions on the amount of participation –** Most all-employee plans set low limits of participation. For example under the UK's SAYE scheme, the maximum that anyone can participate is £250 (E360) a month and the minimum is £5 (E7) a month. The exercise price of the option has to be the current market price subject to a maximum discount of 20%. Similarly, the Share Incentive Plan allows up to £125 (E180) a month to be invested in shares, with a minimum investment of £5 (E7) a month. The average participation in SAYE savings contract is £75(E105) a month with the typical employee saving £50 (E70) a month. These levels are a far cry from the millions in options that is offered to senior executives.

23. **There are no employee performance conditions –** It is very unusual for an all-employee plans to be linked to individual performance. They will generally still be offered if, for example, the employee performs badly, is away sick or is on maternity leave. The only time they will lose the right to exercise an option, or may perhaps forfeit shares held for them in a trust, is if they leave the company. There are however, often provisions for early exit from the plan on favourable terms due to sickness, redundancy, financial needs etc of the employee

24. **Many all-employee plans have tax-favoured plan status** – Tax breaks may be provided for either or both the employer and the employee. For the employee, instead of treating the gain made on the exercise of an option, or the discount on the share price, as employment income, the tax authority exempts this from tax, but treats any subsequent gain on selling the shares as investment income and charges it to capital gains tax. The employee is in effect treated as a shareholder rather than employee throughout the time they participate in the plan.

25. **Non-participation does not create a right to cash substitution -** In the case of a free share plan, if an employee decides they do not want to participate there is usually no right to a "cash alternative". Some companies do offer this, as employees may not always wish to take free shares, but this will always be on a discretionary basis.

26. The conclusion that we draw from this analysis of the characteristics of an all-employee plan is that an employee's participation in such a plan is not part of the

contractual agreement he or she has made with the employer for the provision of their services. This can be contrasted with selective plans where the elements of discretion make a critical difference and link these more or less directly to the contractual arrangement between employer and employee.

27. In brief, all-employee plans are not part of remuneration. The surveys referred to earlier also show that they are not perceived as such by companies.

Incidence of all-employee share plans in the EU

28. The incidence of all-employee plans with the characteristics described above varies widely across the EU. A recent study for the European Foundation provides the most recent and comprehensive overview of all forms of financial participation in the EU[4]. This confirmed that all-employee financial participation is most highly developed in the UK and France and then Germany. What these figures also show is that the number of companies with all-employee plans remains small compared to the total number of firms.

29. In the UK the roots of financial participation go back to the 19th century, but all-employee plans only developed on any large scale with the introduction of tax-advantaged plans in the late 1970s. Today some 1,800 UK quoted companies have an all-employee plan and today there are over 2 million participants in these plans. The Inland Revenue estimate that the total value of shares and options made available to employees over the last 20 years is some £35 billion (E49 billion). Selective plans however out number all-employee plans by over 3 to 1, with some 5,600 companies having a selective option plan for executives.

30. All-employee plans take a variety of forms, including free shares, share purchase plans with or without matching shares and share option plans with or without accompanying savings mechanisms. The amount of equity owned by all the employees in most UK quoted companies is low, often no more than 2 or 3%. In the unquoted sector however, there are a few companies that are wholly or significantly owned by the employees either as a result of an employee buyout or following the retirement of a founding shareholder.

31. In France, financial participation was introduced after World War II and a legal framework and tax incentives have been provided to promote a variety of forms of financial participation, including cash-based profit-sharing and company savings plans for share ownership. It is estimated that about 1,000 companies have a

[4] "Recent Trends in Employee Financial Participation in the European Union" Dr Erik Poutsma Associate Professor Nijmegen Business School for The European Foundation for the Improvement of Living and Working Conditions, 2001

company savings plan [5] with mainly shares in their own company and another 1,000 have employee share ownership plans.

32. In Germany, there are fewer tax incentives, but a considerable body of regulations designed to encourage financial participation. Latest figures show that 2.3 million employees hold shares in 2,700 companies with a total value of E12 billion.

Application of the proposed IAS to all-employee plans

33. In November 2002 the International Accounting Standards Board (IASB) published an exposure draft, ED2, on Share-Based Payment. This states that transfers of an entity's equity instruments by its shareholders to the entity's employees, or to other parties that have supplied goods and services to the entity, are share-based payments unless the purpose of the transfer of equity is "**clearly for a purpose other than payment of goods and services supplied to the entity"** (ED2 paragraph 2).

34. However, underlying ED2 is a fundamental presumption, that all share plans resulting in the award of shares or the grant of options to employees are evidence that the entity has engaged in a transaction in which it has received resources in the form of goods or services as consideration for the issue of those shares or options. The entity should therefore account for the inflow of goods and services and the increase in equity. It must therefore account for the expense arising from the consumption of those goods and services either immediately or at some later time (BC27).

35. ED2 does not therefore envisage any exceptions to the IAS, other than for transactions to which more specific standards apply and specifically rules out an exemption for employee share purchase plans (ED2 Introduction paragraph 2). It does not specifically address all-employee plans in ED2, but does comment and gives its reasoning in relation to employee share purchase plans and the provision of services by employees.

Employee share purchase plans

36. In ED2 the IASB considers the question whether employee share purchase plans should be treated differently from other plans. (Presumably employee share purchase plans have been singled out because these plans are regarded as "non-compensatory" plans in the US.) It states that the main argument advanced in favour of treating these plans differently from other share-based payments is not one of principle. It is based on the argument that to include these plans would be contrary to government policy of encouraging employee share ownership. The IASB does not regard this as a valid reason for treating these plans differently and believes that to do so would impair the quality of financial reporting.

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[5] Since 1967 the Plan d'Epargne d'Enterprise has provided a system of collective savings enabling employees to establish a portfolio of securities.

37. The IASB also considers whether such plans should be exempted because the discount on the share price offered to employees is small. It states that it might be reasonable to do this if the discount is small and the plan has substantially no option feature (presumably this means that there is no opportunity to purchase shares at the most favourable price over a savings period). However it concludes that an exemption would be either problematic (if the maximum acceptable rate of discount had to be defined) or unnecessary (as it should really be covered by materiality provisions).

The provision of services by employees

38. Paragraphs BC31 – BC34 consider and reject the argument that 'The employees do not provide services'. The IASB take the view that if this argument were correct, entities would be issuing valuable share options to employees and getting nothing in return. If this were true the entity's directors would be in breach of their fiduciary duties to the shareholders.

39. The IASB goes on to state "typically shares or options granted to employees form part of the pay package". It argues that, while it is not usually possible to identify the services performed in respect of each element, the employee provides services for the entire package.

Commentary on the IASB's arguments

40. It is ProShare's view that the presumption set out in paragraph 38 above and underlying ED2 is not of universal application and in particular it does not apply to all-employee plans. Moreover, the analysis put forward by the IASB in ED2 is not convincing for the following reasons.

41. Clearly employees do provide services to an entity and they are remunerated for those services. We agree that the remuneration package as described in an employee's contract of employment will often include a number of elements such as basic cash salary, company car, pension, healthcare etc. But the offer to participate in an all-employee plan will not form part of that contractual relationship. As explained above, this is a fundamental difference between an all-employee plan and other plans. In respect of all aspects of an employee's remuneration, an employer contracts to provide them to an employee, whereas in the case of an all-employee plan, the employer will be free to decide whether to offer the plan and the employee decides whether or not he or she participates and to what extent. This is not remuneration.

42. The IASB's argument would lead to the illogical conclusion that an employee who decides to participate in a SAYE scheme to the extent of £100 a month and must therefore save £100 per month out of their post-tax salary would be deemed to be

providing more services to the entity than an employee who chooses only to save £20 per month or than an employee who cannot afford to participate at all.

43. We accept that employees are offered the opportunity to participate in employee share plans because they are employees. But there is a fundamental distinction between what an employee may be offered **in his or her legal capacity as an employee** and what he or she receives **in return for services rendered**. The IASB have confused these two concepts and have assumed that in every case because an individual receives shares or options in an entity these must be in return for services rendered because the individuals are employees of the entity. We accept there will be occasions when this is the case. In those cases, such as executive options, these will be part of the contract for services to be provided by the individual and the shares or options are remuneration. This is not however the case with an all-employee plan.

44. It is often the case that all-employee plans offering free shares incorporate forfeiture conditions under which the employee loses the shares if he or she leaves employment within a certain time period. Similar conditions apply to SAYE if the savings contract is broken and some share purchase plans have "holding" or "blocked" periods. The imposition of these conditions does not however mean that the employees must therefore provide services during the forfeiture or holding period in order to exercise an indefeasible right to their shares at the end of it. Forfeiture conditions are not imposed by entities in order to benefit from any additional services than they would normally receive if the employee was still working for them and they continued to pay them. They tend to be imposed by companies in order to maximise the impact of the plan on all the employees and its value to shareholders and to cover administrative costs. On the other hand holding or blocked periods tend to be imposed only as part of the rules for tax-favoured status.

Identifying the characteristics of an all-employee plan

45. We appreciate that, in order to more closely define the scope of share-based payments, it would be necessary for the IASB to identify the characteristics of an all-employee plan. In other accounting standards exemptions have sometimes been made by naming a particular plan that has statutory-based rules, eg the SAYE scheme in the UK, or by setting numerical limits for discounts or financial levels of participation. We do not think either approach is acceptable in the context of an International Accounting Standard.

46. We do however believe it is possible to set out general principles that will make possible for companies and their auditors to determine whether or not a share plan is an all-employee plan or is offered to employees in return for services looking at the substance of what is offered and the terms of that offer.

47. The key characteristics (as previously set out in paragraphs 15 to 20) are

- **The plan is offered to all employees**
- **Participation by the employee is entirely voluntary**
- **The opportunity to participate is made on "equal" or "similar" terms**
- **The level of participation by the employee is decided by the employee**
- **The offer to participate is not part of a contractual agreement with the employee**
- **It is up to the company to decide when and whether to offer an all-employee plan to their employees.**

48. We believe that these key features would be found in every plan that is currently described as or recognised as an "all-employee" plan. There is already considerable consensus within companies, auditors and professional advisors as to what constitutes such a plan.

49. We appreciate that the IASB would need to consider whether these conditions were suitably robust or whether other conditions would be needed to prevent abuse. For example would an entity create a special subsidiary that employed a select group of people who then participate in a very generous all-employee plan? Under a rules-based regime such an approach might work. But we doubt that under a principled-based standard and given a clear and shared understanding of what an all-employee plan is and means, an auditor would accept such an arrangement as a genuine all-employee plan.

Conclusion

ProShare's view on the application of ED2 to all-employee plans

50. Our answer to the key question addressed in this paper is that all-employee plans are different from other share plans and from share-based payments generally. They create an exception to the general presumption underlying ED2 that all share plans are for the purpose of supplying goods or services to an entity.

51. This is because of the special characteristics of all-employee plans <u>and</u> the clear evidence that companies introduce all-employee plans as a tool to align the interests of employee and shareholder and to instil a feeling of involvement and belonging. This is all supported by the strongly held view of employers, employees and trade

unions[6] that all-employee plans are not part of the pay package and are not in return for services.

52. The fact that all-employee plans are frequently supported by favourable tax regimes and other elements of government policy also supports these arguments but we agree with the IASB that it is not a sufficient argument in itself.

53. We therefore believe that ED2 needs to define its scope more closely to fully reflect the fundamental differences between all-employee plans and share-based payments. We appreciate that it may not be easy to classify every plan as falling within one or the other category, but in the majority of cases the difference is obvious and easily recognised.

54. If it is necessary to define what the entity receives in return for the transfer of non-contractual equity instruments to employees, the answer is not "nothing" as the IASB claims. If there is an "asset" created by these transfers, the best analogy we can find is that it is equivalent to an entity's internally generated goodwill. The goodwill created by the implementation and sustenance of a culture of financial participation through all-employee plans exists outside of the employment of particular employees.

55. The asset created is an intangible one and it is not consumed by an employee fulfilling the terms of his or her contract. Nor does its value ebb and flow depending on the employment of a particular individual. This is not an asset that is consumed and it does not therefore give rise to an expense. The valuation of such an asset is extremely difficult, but it cannot be denied that, like many intangible assets that do not appear on the balance sheet, it has a value. It could be equated to the value provided to an entity by a highly trained or greatly experienced and skilled workforce or the value provided to an entity from the practice of good industrial relations and worker consultation.

56. Finally, there is the critical point of convergence with the US. At present certain share plans are regarded by FASB as "non-compensatory" and therefore not accounted for under the US rules (both ABP Opinion 25 and SFAS 123). The FASB have recently asked for comments on whether these plans should continue to be treated in this way. We support full convergence between the US and EU on international accounting standards. To have similar plans treated differently in the EU and the US would be a major impediment and, in our view, would seriously damage the chances of endorsement of the IFRS by the European Commission.

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[6] "But there is an important difference between the way that remuneration committees use share option schemes to award executives, where it is clear that the schemes are an integral part of the remuneration package. Indeed, in large companies, they are often easily the largest component. As I have said, this is not the case for all-employee share schemes – they are not seen by either employees or, in my understanding, by employers, as a form of pay, and in this sense they are very different from executive share options." Quote from TUC statement 15 January 2003

57. We think the US approach is right, even if their criteria may not be satisfactory. We therefore urge the IASB to reconsider carefully the arguments and to exclude all-employee plans from the final IFRS.

ProShare (UK) Ltd
March 2003