

Accounting Standards Board
Holborn Hall
100 Gray's Inn Road
London
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FAO Paul Ebling

10 January 2003

Dear Sir,

FRED 31

I recently attended a seminar regarding the implementation of FRED 31 and have the following comments:

1. I don't disagree that there should be some form of "notional" charge in the P&L for share based payments. I was reasonably happy with the UITF 17 approach.
2. I don't feel that all aspects and details of FRED 31 as currently proposed and drafted are necessary fully applicable to private companies on at least two counts:

- (i) the proposed complexity/uncertainty of estimating the "fair value"
- (ii) the value (if any) it adds to the users of the account (Shareholders, employees, suppliers, Inland Revenue)

As there is no market price available for a (potential) minority shareholding in a private company (probably in a class of shares with significantly reduced rights to those shares held by the majority shareholders) I believe that a vastly simplified method of calculating "fair value" should be adopted (with appropriate disclosure as to what this is and how it was achieved). Applying a full option pricing model in cases where share options or warrants were issued on a range of dates with a variety of vesting periods and differing performance criteria is almost too horrific to contemplate !

In a private company such as ours the shareholders are fully involved in the process of granting share options (or other forms of share based payments) and are acutely aware of the potential dilution impact on their shareholdings of such awards. Shareholders already factor the number of options, warrants etc into their calculations of the value of their shareholding as a % of the fully diluted share capital, based on their estimates as to the value of the company as a whole. Complex mathematical calculations of a non-cash P&L charge isn't going to add anything to their view of the value of the company. Nor is it what they are paying the CFO to do ! Ultimately, all that is happening is a

potential redistribution of value between existing shareholders and option/warrant holders, no cash is being transferred and it has no impact on the overall value of the company.

Employees are in a similar position to shareholders.

Again, going to great and complex lengths using an option pricing model isn't going to add any additional insights as the solvency and ability of the company to pay its creditors as they fall due. Hence it adds nothing for suppliers.

Finally, the Inland Revenue has its own approach to the taxation of share option awards, and these details are fully disclosed to the Inland Revenue separately, hence putting yet another transaction through the P&L, which they simply "add back", does not help them in any way.

3. I don't agree with the proposal that once initial estimates (e.g. future share value/price, achievement of performance targets, date at which options will be exercised, % employees remaining at exercise date), and the calculation of fair value and P&L charge have been made, that no subsequent re-measurement can be implemented. Surely, these are accounting estimates at one particular point in time and the facility should remain that at the end of subsequent accounting periods to review these estimates (similar to other accounting estimates, such as the useful life/future disposal proceeds of fixed assets, general bad debt provisions, net realisable value of stock etc)?

4. I personally cannot understand the logic of increasing the notional P&L charge in the event that options are re-priced; nor why a charge should continue to be made in the event that the options are cancelled.

5. I don't see, in a privately held group, why there is a need to process the transaction through the books of any wholly owned subsidiary company where options etc in the parent company are granted to subsidiary company employees. What value does this add to shareholders or other users of the accounts ?

6. I am not happy with the fact that the proposed standard impacts any awards after 7 November 2002 (albeit not until the need to restate earlier years in accounting periods ending in 2004). Insufficient time and guidance was available to estimate the impact of applying FRED 31 on a company nor to educate Boards and shareholders as to its impact (both real and presentational). I believe that the earliest "effective date" should be at the point that the FRED becomes an accounting standard and that there should be some element of transitional rules.

7. Overall, these proposals seem to be in conflict with the DTI's apparent desire to increase employee shareholding through initiatives such as the ESOP, SAYE and EMI schemes. The sheer complexity of the proposals are likely to put off small privately owned companies from seeking to use share-options as part of their HR strategy.

My overall views are driven by the fundamental accounting principles that accounts should be (i) relevant, (ii) reliable, (iii) comparable and (iv) understandable; and hence should assist investors to make economic decisions. As you probably judge from my comments above, I

don't believe that FRED 31 as currently proposed achieves objective (i), (iii) nor (iv) and as such does not add any value for investors (current nor future) in private companies that is not already available from the current reporting and disclosure in private company accounts. In fact, I believe that the proposal will make accounts less relevant, comparable and understandable.

I look forward to receiving your response to my comments in due course.

Yours faithfully

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