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Sir David Tweedie,
Chairman,
International Accounting Standards Board,
30 Cannon Street,
London EC4M 6XH,
England.

26th May, 2003

Dear Sir David,

<u>Re: ED2 Share-Based Payments</u>

On foot of an article in *Institutional Investor,* I wrote to you in July 2002 with some initial observations on the issue of expensing share options in financial statements and suggested a framework to accomplish this objective. At that time, you suggested that I should wait until the Exposure Draft on the issue was published and make a detailed submission at that stage. Unfortunately, I did not get the opportunity to voice my concerns during the comment period (which ended on 7th March, 2003) and wish to make a late submission in this regard following some discussion between a member of my staff and Kimberley Clark, the Project Manager.

My company, CRH plc, is one of the most successful companies in the world and I have been its Finance Director since 1987. Since its foundation in 1970, Total Shareholder Return has approximated 18.5% per annum on a compound basis - an incredible record over 33 years. A culture of entrepreneurship together with conservative accounting policies are two of CRH's major distinguishing features.

Since 1973, the Group has operated a series of share option schemes which have been key to fostering the aforementioned entrepreneurial spirit. As you might expect, the design of the current scheme is superior to earlier schemes in that it poses very challenging hurdles which must be satisfied prior to options becoming exercisable; the stringent performance conditions underlying CRH share options may be summarised as follows:

- 3-year options: exercisable only when earnings per share growth exceeds the growth of the Irish Consumer Price Index by *5% compounded* over a period of at least three years subsequent to the granting of the options; and
- 5-year options: exercisable if, over a period of at least five years subsequent to the granting of the options, the growth in EPS exceeds the growth of the Irish Consumer Price Index by *10% compounded* and places the Company in the top 25% of EPS performance of a peer group of international building materials companies. If below the 75th percentile, these options are not exercisable.

From my perspective, there are two fundamental problems stemming from the approach advocated by the Exposure Draft to the valuation of share options and the recognition of the associated expense in the profit and loss account. Whilst supportive of the concept of expensing options in the profit and loss account, 1 wish to make the following observations:

(a) The valuation techniques for options underlying the Black-Scholes/binomial models are highly convoluted and may well be incomprehensible to readers of financial statements. In light of the desire to promote greater relevance and understandability, I would question whether the application of valuation mechanisms such as the Black-Scholes and binomial models adequately serve these objectives.

(b) Given that the Exposure Draft requires that fair value be assessed at the time of grant and that no subsequent amendments to previous charges *are* permitted if actual circumstances vary from expectations, I am of the opinion that the mechanism by which fair values should be discounted to take performance conditions, employee attrition, delayed exercise rights etc. into account introduces an entirely inappropriate level of judgement in the preparation of financial statements. I believe that the approach advocated by the Exposure Draft will inevitably lead to significant variations in practice and render comparisons between entities meaningless.

(c) As outlined above in the context of the CRH Share Option Scheme, it is clear that options issued have little value in the absence of performance being delivered. Given that the Black-Scholes model is not in a position to provide reliable/objective data as to the appropriate level of discount to reflect performance conditions, I believe that a simpler (but arguably more relevant) approach is warranted whereby share options are expensed to the profit and loss account in the years in which EPS growth is sufficient to justify exercise (by corollary, no expense should be reported where performance is not adequate in light of the vesting criteria). This is a fundamental principle around which the expensing of share options in the profit and loss account should revolve (i.e. good profits that allow the performance conditions to be met ale charged with the expense of options whilst poor profits do not bear a charge on the basis that they have failed to meet expectations).

The application of the Black-Scholes model would result in a charge against each year even where EPS fails to satisfy the performance conditions underlying the share options. To my mind, this approach is illogical and makes a nonsense of the fundamental objectives governing the presentation of financial statements as laid out in the IASB Framework.

I believe that my suggested methodology avoids the complexity and the many obstacles associated with the application of valuation models such as the Black-Scholes and provides an understandable and more correct charge in the profit and loss account in respect of share options. I would appreciate your viewpoints on the above.

Yours sincerely,

Harry P. Sheridan