CL 235A

Response from Pearson PLC

P Ebling Esq
Project Director
Accounting Standards Board
Holborn Hall
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20 March 2003

Dear Mr Ebling

FRED 31 – Share Based Payment

Please find attached Pearson Plc's response to the Invitation to Comment on FRED 31 Share-Based Payment.

Our response is restricted to the specific technical questions raised in the FRED but do not cover our general concerns with the overall principles set out in the draft. These concerns are outlined in detail below:

We accept that there is now broad agreement between the major accounting standard setters on the principle that there should be an income statement charge for shares and options. However, the charge that is proposed by FRED 31 is a non cash item that equates to the value to the employee but which does not reflect the economic impact on the company itself. We do not believe that it is appropriate to reflect the economic impact of options on the shareholder through the company's profit and loss account as proposed. We believe that standards should attempt to link to cash as much as possible and would have preferred that the accounting standards bodies had explored other methods of disclosing this impact on investors through measures such as "super" diluted earnings per share with further disclosure within the financial statements.

We are also concerned about the impact on UK listed companies from the lack of a "level playing field" internationally. The risk is that investment in UK listed companies will be affected even though no economic (cash) event has occurred.

If, in the face of these criticisms, a fair value charge along the lines proposed in the FRED is nevertheless inevitable, we believe it essential that the resulting standard is applied consistently across all companies. If companies are given too much latitude in the assumptions and models that they use, the resulting data will be unreliable and of little use to the readers of the accounts. In particular, we would like to draw attention to the following:

- The FRED does not distinguish between companies that hedge their share and share option exposures and those that do not. Companies that hedge their options by purchasing shares to satisfy option awards are already showing the economic cost of options through the funding charges in the profit and loss account and are not diluting the interests of shareholders. The proposals in FRED 31 will show equivalent charges for companies that dilute their shareholders' interests and those that do not. Companies that hedge options will effectively have two charges – the actual cost of funding plus the notional FRED 31 charge, which will remain the same regardless of any decision to hedge.

- We have some reservations about the consistent use of option pricing models. We would prefer that the standard were much more prescriptive in defining the assumptions and the model to be used. In particular, we would appreciate more guidance on the model to be used for employee share schemes so that issues of non transferability, close periods and performance criteria are properly reflected in the resulting charges.

- We are particularly concerned that there is no reversal of the charge where performance criteria are not met and that those companies that have tough performance criteria will have the same charge as those that do not.

The charges that are likely to arise on implementation of FRED 31 will be significant for Pearson and many other companies and will distort the underlying business performance reported in the profit and loss account. If this leads to companies attempting to explain profit performance by excluding these charges, then some of the impact of the proposed standard will be lost.

We trust our comments our useful and look forward to hearing your views

Yours sincerely

Rona Fairhead

Chief Financial Officer
Pearson Plc