

26 November 2005

Rt. Hon Jacqui Smith MP
Minister of State for Industry and the Regions
Department of Trade and Industry
1 Victoria Street
LONDON
SW1H 0ET

Dear Ms Smith,

EU Endorsement of IFRS2 – Share-based payments

Further to our letter of 17 August in which the UK Society of Investment Professionals (UKSIP) urged for the full endorsement of the proposals for IAS39, the Society is writing to encourage your continuing support for IFRS2.

As you are aware, UKSIP has consistently supported and encouraged the development of International Financial Reporting Standards (IFRS) by the International Accounting Standards Board (IASB) over a number of years. The Society believes that the development of IFRS represents a major contribution to providing consistent and comparable financial information across the capital markets, delivering a range of significant benefits. It has been encouraged by the support that the UK Government has given to this process.

The recent decision by the Accounting Regulatory Committee to give a favourable opinion on the European Commission's proposal to endorse an amended version of IAS39, rather than the full standard, represents an unhelpful precedent for the endorsement process of other, as yet unadopted, IASB Standards and IFRS. In particular UKSIP would like to re-emphasise its continuing support for IFRS2 Share-based payments. Accounting for share-based payments - and especially employee share option schemes - has been a highly contentious and vigorously debated issue for some time. UKSIP and the CFA Institute have consistently and wholeheartedly supported the principles that lie behind IFRS2, namely that share-based payments, including share options, should be recognised as a cost in the income statement as they can be reliably measured and represent remuneration in the hands of the recipient.

It has been argued in the past, however, that new entrepreneurial enterprises, often of a technological nature, rely heavily upon share-based payments as a means of financing themselves and incentivising and rewarding their employees. Accordingly, recognition of the cost of share based payments it is argued, would adversely affect these businesses by reducing their apparent returns.

UKSIP does not accept these arguments. Ignoring these payments would mean that costs were understated and apparent returns were overstated, a situation which is

unhelpful to both the company and investor. In addition, it would distort the efficient allocation of capital between companies that finance themselves by share based payments (who could ignore such costs) and those other enterprises, with equivalent risks and returns, which are financed in other ways.

The ability of such new hi-tech companies to attract finance will always depend more on the capability of their people, the ingenuity of their technology and their actual delivery against the expectations that they create. Expensing share based payments will not affect their ability to develop or to raise finance from the sophisticated capital markets.

The apparent failure of the EU to endorse IAS39 in full may encourage other parties to pursue a policy of attacking those IFRS and IASB revised Standards that are as yet unendorsed. UKSIP would encourage the UK Government to resist all such pressure and continue to support the full endorsement of all IASB standards by the EU.

A R Good ASIP
Chairman, UKSIP Accounting Advocacy Committee

J E Rogers
Chief Executive