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it's our business

newspad of the Employee Share Ownership Centre

Sharesave accounting madness approved by UK standards board

The last redoubt against the IFRIC D11 SAYE-Sharesave contract share schemes accounting madness has fallen. The UK Accounting Standards Board (ASB) on March 27 issued an amendment to Financial Reporting Standard (FRS) 20 (IFRS 2) Share-based Payment – Vesting Conditions and Cancellations, toeing the line established by the International Accounting Standards Board, despite industry protests.

This festering row is about how to account for cancellations by employees of their monthly savings contracts in Sharesave option schemes which are 'underwater' – where their share price has fallen below, or even well below, the initial option price offer to participating employees.

In such cases, employee participants may consider leaving the scheme if there is little chance of them being able to make a future gain by using their Sharesave savings to buy the company share options when the scheme matures. Their calculations hinge on how far below the option strike price the current market share price has fallen.

The IASB has ordered a punitive up-front immediate full cancellation charge (i.e. the hypothetical entire three or five year life 'fair value' of the cancelled employee share options), to be imposed on the bottom line of the sponsoring company's annual accounts.

ASB chairman Ian Mackintosh held out a long time against the IASB diktat, expressing fears shared by the Centre that such a ruling would lead to problems in the Eso industry, but ultimately to no avail.

Some large companies which sponsor SAYE-Sharesave schemes in preference to the Share Incentive Plan fear that they will face heavy accounting charges if they launch new lower priced employee option contracts – the traditional response to a falling share price - in order to 're-incentivise' employee participants dismayed by their underwater options in current Sharesave contracts. Forewarned Sharesave sponsoring companies might choose to avoid the charge by refusing to issue new contracts until the old ones have expired after three or five years, whether in the money or not. That would upset participating employees, who might feel cheated, and lead to reduced share scheme activity, which the industry can ill afford.

Some employee share purchase plans are likely to be affected in a similar way.

However, there was a glimmer of hope in some quarters that the worst implications of the notorious D11 ruling may be avoided in some cases, because accounting officials could move the vesting condition goalposts via a process known as 'modification treatment.' This involves treating the new Sharesave option as a replacement for the cancelled option – in which case the remaining charge for the cancelled options continues as if it still existed (rather than being accelerated). The fair value of the new option has to be recognised, but this is reduced by the value of the old option. This could provide a more acceptable accounting outcome.

But practitioners were divided as to whether this would save the day for the majority of underwater scheme option cancellations. William Franklin Senior Associate (Non Solicitor) Pinsent Masons LLP, explained: "So far attention on the revised standard has focused on its impact on SAYE options, but the revisions fundamentally change the definition of a vesting condition and introduce a new concept of a non vesting condition. When the revisions come into effect it will be interesting to see how these new rules are applied"

The ASB amendment clarifies the treatment of cancellations of options granted to employees, following similar amendments issued in January by the IASB. Under FRS 20 and IFRS 2, where share options are granted to employees, the value of the option at grant date is treated as an expense over the period in which services are received from the employees in exchange for the options – normally the period until the options can be exercised. Where an option is unable to be exercised because vesting conditions are not met (e.g, if a performance target is

From the Chairman

It will be good to think that with the acquisition of New Bridge Street by Hewitts the legacy of the late great Laurie Brennan will be safeguarded. Laurie was recruited to head the new firm - the first multidisciplinary partnership - by Sir Max Williams and David Reid of Clifford Turner. He brought a commitment, pace and audacity which has not been matched. He raised his head and put in first place the interests of development of employee share plans, humbling the government as well as bystanders on the way. What brutal fix might he have proposed for the rewards of failure which disfigure our work? Meanwhile in the US an advocate of the same vintage turns operator. Francophone David Binns moves to an employee owned company from the realms of think-tankery. We shall be rooting for you, David!

Malcolm Hurlston

not met, or the employee leaves the employment) the cost of the options is reversed. However, if the employer cancels the options, the full value of the options is charged to the profit and loss account. The IASB has issued an amendment, which would clarify that, where options are cancelled by the employee (other than on leaving employment), such cancellations should be treated in the same way as cancellations by the employer. FRS 20, effective for accounting periods beginning on or after 1 January 2005 for listed entities, and 1 January 2006 for unlisted entities, is in most respects identical to IFRS 2. The ASB is making corresponding changes to FRS 20 to keep it in line with the international standard. The amendment will apply for accounting periods beginning on or after 1 January 2009.

Practitioner members fought these proposals bitterly, with Centre backing, arguing that they were – and still are – deeply flawed from a conceptual standpoint.

The Centre invites readers to provide us with some data (omitting the company name if you wish), which outlines the size of the scheme, the drop in share price (below the option strike price), and the net charge that the company expects to pay through cancellations. The Centre is collating evidence to submit to the European Financial Reporting Advisory Group (EFRAG)which has issued an invitation for comment by April 14 on its assessment of the amendment against the EU endorsement criteria and on its initial assessment of the costs and benefits that would arise from the application of IFRS2 in the EU.

CENTRE CONFIRMS SPONSORED DUBAI CONFERENCE

The Centre has reached agreement with Emirates National Bank of Dubai for the staging of a first joint middle-east Esops conference, scheduled to take place in Dubai at a five star hotel on November 17 & 18, with 150 delegates attending. This historic event will kick-start a longer-term programme of conferences and seminars aimed at bringing Esops and related plans to the Gulf and neighbouring states. Centre chairman Malcolm Hurlston said: "I am pleased to announce that we are working together with the Bank which will be the prime sponsor. Co-sponsorship opportunities for the first conference are now on offer and Centre members who wish to sponsor and/or speak should contact fhackworth@hurlstons.com asap.

TROUGH FOR RUNNERS-UP

The Association of British Insurers has written to leading remuneration consultants, complaining of a growing trend whereby companies make 'hard luck' one-off payments to internal directors who have failed to be appointed as the next chief executive. The payments are often substantial and made in either cash or shares.

The letter said: "Additional awards to unsuccessful candidates, particularly if there are no performance conditions attached, should be the exception rather than the norm." Although the ABI, whose members own 20 percent of the shares listed on the LSE, did not mention specific examples, GlaxoSmithKline's succession planning is a case in point. Last year it was announced that Andrew Witty, the head of the European division, was to replace Jean-Pierre Garnier as head of the company in June. The announcement came after an 18-month internal hunt for a new ceo during which two other senior candidates, David Stout and Chris Viehbacher, emerged as frontrunners with Witty. After appointing Witty, GSK is thought to have offered substantial payments to Stout and Viehbacher to persuade them to stay. But in December Stout, who was the head of pharmaceuticals, said he would leave GSK, while Viehbacher was appointed to the executive board. He kept his job as head of pharmaceuticals in the US.

Peter Montagnon, the ABI's director of investment affairs, told The Sunday Telegraph: "We accept that it is important to incentivise good directors but we are concerned that these one-off payments are being approved automatically. Companies need to explain the payments." An investor said: "Often the jobs of the failed candidates don't change so it doesn't really make sense for them to be paid more. I think we need to be very careful about this." The letter is a warning shot to companies about to start internal searches for new bosses. The formal process to find a successor for Ben Verwaayen, the BT ceo, is expected to begin soon. Meanwhile BAE Systems, Britain's largest defence contractor, is looking for a new ceo to replace Mike Turner.

CREDIT CRUNCH

More than 14,000 Bear Stearns employee shareholders feared the worst as their employer was apparently being sold to JP Morgan Chase for $10 per share (after an initial offer of only $2 per share was improved). Bear Stearns was heavily committed to employee equity and senior executives and middle management are sitting on heavy losses from their company option and deferred share incentive schemes. Corey Rosen, executive director of the National Center for Employee Ownership, said that the Esop, funded by the company, held £140m worth of Bear Stearns stock last year and that has taken a nosedive. Losses among those still in the Esop will be almost total.

However, the Bear Stearns Esop only accounted for about three percent of Bear Stearns stock The really big losses have been racked up by executive participants in stock appreciation, restricted stock and stock award plans, which were collectively worth around £300m, before the ordure hit the fan, he pointed out. Sadly, Bear Stearns executives were encouraged to buy the company stock…….Rank and file employees however are cushioned by a profit sharing plan worth £150m and a 401K plan worth £360m, both in diversified investments.

Bear Stearns stock plummeted from $169 per share to just $30 after the announcement of a Fed inspired liquidity bail-out plan, but even that failed to save it from the forced takeover. The employees include 1,400 based in Canary Wharf, many in the prime broking business and about one third are about to lose their jobs.

Peter Leach, director of Killik Employee Services, points out that though Company Share Option Plans and Share Incentive Plans carry risk from the outset, SAYE plans become risky for those people who buy shares and hold on to them. "SAYE plans are very safe up to the moment you exercise your option to buy the shares, but if you hold on to the shares rather than sell them that same day you become exposed to market volatility," he said. "HBOS is a good example of how the benefits of share schemes can turn sour if you don't cash in straight away. Last February, when a tranche of its SAYE scheme matured, 50,000 employees were celebrating a combined payout of £210m, netting an average £2,440 profit on an investment of just £1,830. However, any employees who hung on to their shares may have lost some of the benefit of the share plan because of the subsequent downward slide in the value of the company. Even after the rebound, following Hornby's* heroic intervention, HBOS's share price was still only £5.44, but since then the share price has climbed back to around £5.90. Some employees who have been saving in share schemes for years could be holding all their eggs in one basket, which is great when the share price is rising, but can be disastrous if it falls," Leach added. He recommends cashing in shares when schemes mature and spreading the investment across a range of assets". *CEO Andy Hornby's £6m share-support move produced a £2.3bn reward for HBOS after shares in the bank rose a stunning 15 percent in one day's trading. Hornby led a group of 250 senior executives who bought 1.4m of its shares to boost the bank's standing after it was rocked by false market rumours, engineered by short-sellers.

HEWITT ACQUIRES NBSC

Hewitt Associates has acquired New Bridge Street Consultants. Hewitt's UK executive compensation team will join forces with the NBSC team, to become Hewitt New Bridge Street, which will have 50 UK consultants specialising in executive compensation and employee share plans, and will be part of the wider Hewitt HR consulting practice. Initially they will all be based in NBSC's offices in Little Britain, but the plan is to relocate the entire team to Hewitt's More London Place office later this year. Principal consultant Les Moss told newspad: "This is a very significant development in the industry as it brings together the strengths of NBSC's very substantial UK-based share plan and executive remuneration practice with Hewitt's global reach and leading position in the US market. For me personally, it is a coming home as I spent a year with NBSC in the mid-eighties working with the late lamented Laurie Brennan. Everyone and everything at NBSC will continue as before, but the biggest change is being experienced by the seven Hewitt exec comp/share plan people who have relocated to Little Britain and in effect joined NBSC. The partners of NBSC, such as Neil Sharpe, become Principals of Hewitt, alongside the existing three Hewitt EC Principals (myself, Jeremy Orbell and David Tuch). John Lee, Managing Partner of NBSC, will run the EC team as a whole within Hewitt's HR practice." Meanwhile, Hewitt's contact details are unchanged: 6 More London Place, Tooley Street, London SE1 2DA Tel +44 20 7939 4434 Fax +44 20 7939 4466 Mobile +44 7908 223481 leslie.moss@hewitt.com

ON THE MOVE

Michael Carter moved to lawyers Addleshaw Goddard in the role of corporate partner, to help lead the firm's City-based share incentives team through the next stages of its growth. Michael spent 12 years with KPMG, where he was a partner and latterly head of middle market & regions in executive compensation and incentive planning. Paul Devitt, Addleshaw's corporate managing partner said: "Michael's experience and track record complement our existing capability and provide us with a stronger platform from which to continue to grow and develop this important discipline." His experience includes reviewing remuneration and reward strategies against business objectives, compensation and performance benchmarking, designing and costing of compensation programmes, and implementation and communication of new compensation programmes. He also advises on best practice and changing legislation, designing, drafting and implementing new plans and advising on international share schemes. Addleshaw Goddard's client base comprises listed companies, SME unquoted companies, non-UK companies, venture capital houses and management teams.

David Binns, former director of the US Esop Association, has left his post at the US based Beyster Institute after 17 years to become ceo of employee-owned company Macfadden. He said: "As I've joined an employee-owned company, I look forward to maintaining active involvement with the greater employee ownership community." Macfadden and Associates, Inc, a privately held professional services company providing humanitarian disaster assistance, integrated information technology and programme management services and support, announced last yr that its Employee Stock Ownership Plan (ESOP) Trust had acquired 100 percent of the outstanding shares of Macfadden. Former President and founder, Jim Macfadden stepped down and sold his remaining company stock to the employees. Contact info: David Binns, CEO Macfadden 8403 Colesville Road Silver Spring Metro Plaza 2, Suite 280 Silver Spring, MD 20910 Tel: +1 301 588 5900 Cell: +1 240 565 3816 Fax: +1 301 588 0390 dbinns@macf.com - www.macf..com

Beatrice Chivers recently moved from Ernst & Young to work with Colin Kendon at Bird & Bird. Her email address is: beatrice.chivers@twobirds.com and her phone number is: +44 20 7415 6000 switch or +44 20 7982 6519 direct

CONFERENCES

CANNES

More than 40 delegates so far have registered for the European Centre's 20th anniversary conference at the Majestic Hotel, Cannes, on Thursday June 5 and Friday June 6. The Centre has only a few hotel rooms left from its pre-booked allocation and so prospective delegates are advised to register asap to avoid being sent to another Cannes hotel. Details of the speakers and admission prices etc are to be found on the Centre website at: www.hurlstons.com/esop and click onto the 'events' tab. Alternatively, email the name(s) of your delegate(s) to Fred Hackworth at: fhackworth@hurlstons.com

JERSEY TRUSTEES

The next Centre-STEP Channel Islands conference, held in association with the Society of Trust & Estate Practitioners, will take place on Friday, July 11 2008 at the Royal Yacht Hotel, St Helier. It will focus on: the impact of recent and upcoming regulatory/legislative changes on trustees of ESOs (e.g. IASB, CGT, Jersey company law etc) issues for trustees of EBTs of private equity owned companies.

CENTRE-IOD

The annual Centre-Institute Of Directors conference for SMEs will take place on September 17 in London. Further information about the event will be available soon.

All enquiries about speaker roles for Jersey, or delegate attendance at the IoD to Joel Lewis at Centre head office: Tel +44 20 7436 9936 and by email to jlewis@hurlstons.com

COMPANIES

Eighty percent of Europe's largest companies had an employee share plan in 2007, up from 50 percent in 2000, just 20 percent in 1994 and ten percent in 1986. All EU countries are involved, though in most of the Mediterranean bloc, Eso is still largely confined to employees of multinational companies.

Banking giant Goldman Sachs warned of massive pay cuts for its staff as the global economic crisis bites. The world's most profitable bank, known for having the best-paid employees in the City, admitted its pay and bonuses fund had shrunk by more than a third compared with this time a year ago.

Directors at the Royal Bank of Scotland have missed out on their long-term bonuses for the second year running after failing to meet performance targets. Even so, Sir Fred Goodwin, the chief executive, received £4.2m, up from £3.9m in 2006, and cashed in share options worth almost £1m. Johnny Cameron, who runs the investment banking arm, received £3.2m, down from £3.4m. Meanwhile, the Swiss bank UBS revealed that its chairman, Marcel Ospel, took a 90 percent pay cut last year.

Kate Swann, ceo of high street newsagent WH Smith, secured a maximum bonus payout of £2.45m only after closing the final salary pension scheme last year. Without the £2m annual saving this brought the company would have missed the profit target under Ms Swann's three-year management investment plan, set up in 2004. WH Smith confirmed that her bonus would have been £120,000 lower had the pension scheme been left open. Ann Field, national officer at Unite union, said: "She's brought executive reward to a new low, though, earning a bonus by destroying other people's pensions." The Retail Book Association estimated that a scheme member aged 45 on £380 a week would have amassed a pension paying £80 a week by 65. Following the change, they will get just £29.60.

DAMP SQUIB BUDGET

Private equity firms pronounced themselves "disappointed" with Chancellor Alistair Darling's first Budget, because nothing was done to ease the restrictions which make it extremely difficult for them to introduce all-employee share schemes for rank and file employees in companies they have recently acquired. The biggest stumbling block – the requirement that to achieve Approved share scheme status, the company launching the Eso plan must not be under the control of another company – remains in force. The Centre is lobbying the Treasury with firepower from Clifford Chance on this key issue.

NEW BOOK REVIEW: Malcolm Hurlston writes: "At different paces and in different modes employee ownership is spreading worldwide and anybody with a wish to have an overview of the world in one tome will welcome David Binns' new book - Employee Financial Participation: An International Survey. There are as many countries and regions covered as there are letters of the alphabet, each with a practical mix of detail and concision. David Binns is a former director of the Esop Association and more recently of the Beyster Institute. When he was at the Institute he joined the Centre - as a rare American francophone - in a joint French language seminar in Paris, the aim of which was to acquaint the French with Anglo-Saxon Esop developments. David asserts the role of financial participation in improving productivity and expanding GDP. A must for the Esop shelf." ISBN: 978-0-9802483-0-2 available at $45 from amazon.com or beysterinstitute.ucsd.edu

APPROVED PERFORMANCE SHARE PLAN

The APSP enables participants to receive tax efficient free shares under a Performance Share Plan. Newly developed by Deloitte, the APSP is a Performance Share Plan run in conjunction with an HMRC approved Company Share Option Plan. It allows employers to offer employees the benefits of a free share award with the tax efficiency of an approved option. By making use of the CSOP arrangement, the APSP enables the growth in value on a free share award of up to £30,000 to fall within the favourable CGT regime. As a consequence, no income tax or national insurance contributions are payable on this growth in value, resulting in tax and/or NIC savings for the employee and his employing company.

As an example: a company wishes to make a PSP award to an employee worth £50,000 at the date of award. Under a standard PSP, the employee would receive an award over shares worth £50,000. Under the APSP, the employee would receive a share option over shares worth £30,000 (provided that the employee's full CSOP limit is available), a funding award to fund the exercise price of the share option and a PSP award over shares worth £20,000. Assuming that the company's share price rises, the APSP award would work as follows:

Year 0 – share price is £2 share option granted over 15,000 shares; funding award granted to fund the exercise of the share option; and PSP award granted over 10,000 shares.

Year 3 – share price is £5 funding award vests to fund the exercise of the share option; share option is exercised in full and 15,000 shares are acquired for £30,000 (the shares would now be worth £75,000); and PSP award vests giving 10,000 shares worth £50,000. The employee receives the same gross benefit of £125,000 as he would have done had a standard PSP award been granted to him over shares worth £50,000. However, the difference is that the growth in value on the share option of £45,000 (being £75,000 less the £30,000 exercise price) is not subject to income tax or NIC (unlike a standard PSP award), giving the employee an increased net benefit. The employer also saves employer's NIC on this growth (currently at a rate of 12.8 percent), a saving in this case of £5,760. Any subsequent sale of the shares acquired under the share option may be subject to CGT. Contacts: Claire Wesley (Partner, Global Employer Services), Deloitte & Touche LLP Tel: +44 20 7303 4412 E-mail: clwesley@deloitte.co.uk and Bill Cohen (Partner, Global Employer Services), Deloitte & Touche LLP Tel: +44 20 7007 2952 E-mail: wacohen@deloitte.co.uk

The Employee Share Ownership Centre Ltd is a members' organisation which lobbies, informs and researches on behalf of employee share ownership.