

LABOR COSTS AND PROFESSIONAL ACCOUNTING NORMS

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SUMMARY

With the objective of an improvement in efficiency and attainment of managerial objectives of profitability, to the personnel that acts in enterprises and especially at hierarchical level, one has always tried to motivate through recompenses in different ways, be these monetary or of other characteristics.

At present, different modalities exist of granting benefits to the employees. One of them is giving them enterprise stock Purchase Option and, in this way the personnel, will be able to obtain a personal gain in the future, with the condition of rendering services for a time period, or to achieve a performance desired by the owners of the enterprises, so as to improve its management, and with the desire of increasing the market value of the shares. This practice has been used by entities that operate at international level and the most diffused case in the world, is that of the North American enterprise Enron.

At present, norms exist for the registration and rating of the stock Purchase Options of the nature mentioned in the previous paragraph in the USA and, at international level, a draft of an

International Accounting Norm. But the problem to be solved is to establish how to recognize these manual labor costs as such in the Argentine Republic; keeping in mind the particularities of the economic reality that underlies in our country and that can be characterized as hidden due to a regulatory hole on the topic. Thus up to the present there does not exist the exteriorization eligibility in the Accountable States, neither obligatory countable regulatory schemes for the professionals of the area, that guide them if they should incorporate them to the patrimony or not.

We will propose a recognition and rating procedure, with their corresponding information to be presented in the Accountable States, within the Conceptual Framework and in accordance with the measure agreed on by the profession.

KEY WORDS: Labor costs, Stock Purchase Options belonging to the enterprise itself. Registration and agreement proposal according to valid norms.

INTRODUCTION

It is agreed that the birth of Accounting was due to the necessity of the owners of the capital of knowing the magnitude of their patrimony, and the results of their business. Through time, the entrepreneurial enterprise reached considerable levels (then enterprise and capital owners) noticed the convenience of getting capital from third parties, to finance the development of their enterprises, with the objective of obtaining a growth of their benefits. This differentiation process of managers' concept (enterprise owner) and financier (capital owner) went on acquiring relevance to such a point that, at present, the owners of the capital of big enterprises are absolutely separated from those who are in charge of the ones making the decisions in the management of the enterprises.¹

¹ DAVID, Julio y YARDÍN, Amaro. "Objetivos de los estados Contables destinados a terceros". Actas de Congreso IAPUCO, 2001

Between 1995 and 2000, the USA capitalism generated a sustained growth and, as consequence of this increase, it was adopted as a "model" to be followed by different countries of the world; extending then progressively to the management of multinational enterprises, in what was called corporate governance; enterprise government, as a solution to the opposition of the shareholders' interests and of those of the managers.² This Government form implies that the enterprises are managed by people that are not the owners of the enterprises and, with the purpose of increasing their utilities, to induce to make decisions on behalf of the shareholders and thus to obtain an increase of the value of the shares in the Exchange with increasing dividends, to the higher echelons and enterprise directors are given participation in the business, by means of prizes due to the results obtained. Also to the rest of the personnel, but much less than to their managers.

1. Payment Terms

Among the different modalities of prizes or recompenses due to the results obtained, with the objective of obtaining an adhesion and permanency of the hierarchical personnel in the enterprise and, as a practice much more diffused, said incentives can consist of compensations direct or indirectly based in the value of the enterprise shares. We can mention:

- Immediate or differed handing over of shares;
- Share appreciation rights, as the benefit to receive on a certain date the difference between the market price of the shares at that moment and an established price at the moment to grant the benefit for the number of shares, that can be paid in cash or in shares or a mixed modality;
- To grant Purchase Options on enterprise shares at a fixed price called strike price and that it can be paid in cash or by means of the handing over of the shares or giving him new options, with due date. With the purchase of shares as investment, among other

² TOUSSAINT, Eric. (29 de febrero de 2004). "La debacle de la nueva economía made in USA. Enron y Compañía" La Insignia.

placements of funds, the employees in USA conform their Pension Funds.³ At present nearly 50% of the Social Capital of the Pension Funds is made up of enterprise shares; or

- Plans of Participated Property, PPP, or ESOPs, Employee Stock Ownership Plans, whose antecedents we find in the USA and that was adopted in the Argentine Republic with its own characteristics. The use of these plans causes tributary benefits that consist, mainly in that the enterprises can discount from their taxes an important part of the donations that they give their workers, with the purpose that these buy enterprise shares or that they can pay obtained credits with this same purpose. The workers, on the other hand, are exempt of the taxes for these donations, as well as the Financial Institutions which lend the money for said plans, are excepted of paying taxes for the interests that they perceive for these loans. As a result of the previous measures, the financing obtained by the enterprises through this mechanism has a cost that is some points inferior to the average. The plans stimulate the permanency of the workers within the enterprises until their retirement.

In our country this last modality was implemented due to Law N° 23,696/89, State Reform Law⁴, which began a wide process of enterprise privatizations and activities that were in charge of the Public Sector and that became transferred to the private sector of important activities with the consequent creation of numerous Joint Stock Companies. This system consisted on granting a percentage of the capital in ordinary shares of the privatized enterprises to its employees. The mechanism used for it, is that the shares that are the workers' proprietorship should be put in a trusteeship, which administers them until the worker's retirement from the enterprise. One of the consequences which it caused was that almost all the workers sold their shares, operation which, although it reported good earnings, at the same time it moved them away from the propriety and management of those enterprises.

3 The pension funds are institutions which through the contributions of their partners generate investments to improve the social security pension systems. Yera, Luis Marcelo. "The property crisis in the transnational corporations: a present day expression of imperialist decadence". 07/02/05 . www.paginadigital.com.ar

4 Articles 21°: 40°.

2. Transactions to put or options

We will dedicate ourselves to the study of negotiated benefits to executives or managers of organizations by means of the delivery of Call options on shares of the enterprise itself. In consequence, we will define the transactions in the first place to put or options, then to analyze the operative in particular and the applicable countable norms of the same ones in the USA, at international level and in the Argentine Republic.

2.1. Definition

The Contracts of Options are one of the applicable derivative financial instruments to covering risks, be it for purchase: call, as put. The modern definition of options is that of a contract in which the drawee by means of the payment of a put, acquires from the drawer the right to obtain compensations that delimit the effects of the fluctuation of certain economic variables. The economic variables can be: the levels of interest rates, exchange rates, prices of goods, shares, funds, stock market indexes, etc. They are bilateral contracts that are marketed through financial middlemen, where the right is acquired and the obligation does not contract; it only represents a potential right. This right can be the one of, to acquire or to sell. The call option gives to the holder the right of acquiring an underlying good at an established price. While a put option gives the right of selling an underlying one, at a specific price up till the date of maturity and it is an opposed position to the call option. Who sells an option is called a "seller" and is the person who is under an obligation of fulfilling with the right that the option contract grants the "buyer."

The buyer or "drawee", on the other hand, by means of the payment of a price, called put, acquires the right of the contract is called "strike price", which is the price at which the contract buyer will have the right to buy or sell subjacent goods. The seller of an option can do it in not overdraft or overdraft way. If he does it in a not overdraft way, the seller should have in the portfolio, the kind and quantity of the subjacent goods, which he negotiates in the option. If it is in a overdraft way, he is not obliged to have in portfolio the subjacent goods.

Their use is given with the objective of reducing the fluctuations of the economic performance of the enterprises, as consequence of the financial risks to which they can be exposed. The options allow to have smaller transaction costs and to provide covering in the face of changes not anticipated in the prices of subjacent goods, offering opportunities of loans and placement of funds under more favorable conditions. The same as in contracts to term and to future, the economic agent units exposed to financial risks through middlemen and agents; and the investors and speculators, likewise the arbitragers. And the Clearing House, in the stock markets, they act interposing themselves between the seller or salesperson and the drawee of the options, eliminating the direct bond between them.

2.2. Benefits to employees

The incentives of granting their workers call options on shares was the particularity most adopted in the USA from the 1980s onwards. It consists on giving him the possibility to acquire enterprise shares, where they develop their functions, to an inferior price to that of the Stock Exchange, and this way to resell them in the future when these have increased.

The plan contemplates the award of the option and when issued, a price is fixed which is denominated "strike price". But the option cannot be exercised during a time that is to say that its maturity terms are long, years, considering the waiting period or unavailability. This participation is conditioned to certain demands, among them and the most important, is that the employee continue his labor relationship within the enterprise for a period of time that is generally up to when the option can be exercised.

Concluded the unavailability period, the employee can exercise the option; this exercise takes place if the price of the action rose during that time. To exercise the option implies to buy the shares at said fixed price or of exercise, and then to resell them in the Stock Exchange at rate value, obtaining the gain due to security differences. This level of transactions generates a significant increase in the commercialization volume in the Stock Exchange and the enterprises are

extremely attractive for the investors capturing in this way more capital in the market and also raising even more the market price of the shares. If the market price of the shares is smaller to the strike price, the option is not exercised, since it is more economic to buy them in the Stock Exchange.

This practice of compensating with call options has represented, in the USA, around 60% in concept of annual allowances to workers, an equivalent of 5% of the basic salary and the executives and managers have been granted more important sums. The most notorious case was the enterprise Enron that on 20th August 2001 its Executive Director (Ken Lay) transformed the options into shares and sold them in the market for value of 519,000 dollars; the following day he repeats the operation, but this time, for value of 1.48 million dollars. Such a procedure was followed by his 29 peers transforming personal earnings into more than a billion. This accelerated the fall of the shares in the market and at the same time, all the employees had been handicapped of exercising the right of selling their shares, since the Enron Pension Fund (personnel savings plan) it was declared to be restructuring and all the transactions had been blocked with the suspension of the transactions with shares property of the plan for the term of 30 days. And those that possessed options could not exercise them. This procedure, jointly with other transactions of speculative character, determined that on 2nd December 2001 the enterprise requested bankruptcy.

In the Argentine Republic no records have been found as to this, but due to growing globalization and, the constant tran-nationalization of the economic and financial activity, it is not unaware that these transactions could take place in the future, since the national barriers have had a considerable opening and in our territory these operate economic groups whose capitals are not completely national or they participate in a small percentage without having the control of the enterprises.

2.3. Countable treatment of the Call options

2.3.1. in the USA

The countable treatment is regulated in the United States by the Financial Accounting Standards Board, Stamford, FASB and it is found in three publications, that is to say: the Statement of Financial Accounting Standards (SFAS) N° 123 Accounting for Stock-Based compensation, the SFAS N° 148 Accounting for Stock-Based Compensation - Transition and Disclosure and, the Opinión N° 25 of the Accounting Principles Board (APB) Accounting for Stock Issued to Employees.

The Statement of Financial Accounting Concepts N° 6, SFAC, Conceptual Framework, defines as Passive the present obligations of transferring economic or active benefits in the future to another entity as a result of transactions or past events, and the capital as the residual interest in the assets of the entity that remains after the deduction of the liabilities; however to the options handed over to the employees it considers them as instruments of capital and not as liabilities. This conception is based in that during the services period of of the employees' which have not completed the performance which is wanted to be recognized, the enterprise does not transfer cash or other assets to the employees, it will only emit a capital instrument in the future, and in consequence there does not exist the obligation of transferring economical benefits, therefore there is a passive. Also, in Section C 36 of the SFAS 133, Stock-Based compensation, establishes that the compensations based on shares from enterprise itself, to the employees as part of their remuneration, do not constitute Passives. But the capital instruments issued with the proposed objective, and the cost of the services received as retribution should be valued and to be recognized according to the fair value method, according to SFAS 123 and 148, that is to say to be shown in the Financial State, with responsibility to the Results State.

According to SFAS 123 and 148, the regulatory scheme should be applied for all the transactions in which those societies grant shares, options or other capital instruments to their employees, except for Equity Stock Ownership Plans, ESOPs, regulated by the AICPA (American

Institute of Certified Public Accountants) Statement of Position N° 93-6, Employers' accounting for Employee Stock Ownership Plans. That recognition has its foundation in that the costs of all the compensations to employees based on shares arise from considering that:

- The options to employees have value;
- The financial instruments granted to the employees bear Compensatory Costs that should be recognized in the determination of the results of the enterprise; and
- The value of the options to employees can be calculated within the acceptable limits of recognition in the Financial State. Not recognizing that there exist Compensatory Costs, determines that the option does not have value, be it for the employees as for the enterprise.

The spirit of the norm is that an option has value when it is granted, without caring if it is exercised or not, or if the option expired and lacks value at the end of its life. The rating of the option consists on determining the estimate of the fair value, in function of the price of the share on the day on which the options are granted, whose employees will be holders after having completed the period of rendering services. Then, to determine the fair value of a stock purchase option, mathematical models are used as that of Black and Scholes' or Cox, Ross and Rubinstein's (binomial), on the date of granting the plan and these are based on:

- The strike price of the option;
- The expected life of the option;
- The current value of the share;
- The prospective dividends on the share; and
- The rate of free risk during the prospective period of the share.

Although these mathematical models were designed to determine the value of the options that can be transferred, i.e. to be sold, the options delivered to the employees, cannot be done, and they can only be exercised when the rendering of services has been yielded. If it was not been yielded, the value of the option is zero. Indeed, while the period of benefit has not been completed,

the enterprise does not have the obligation of emitting the capital instrument, although it partially recognizes the results or Compensatory Cost, exercise after fiscal year. The transaction is perfected when the rendering period concludes. These services are recognized according to an estimate of the value of the capital instrument that will be issued. Also, once the capital instrument was issued, the future changes are not recognized in the value of the instrument on behalf of the enterprise, this is losses or earnings derived from it.

The Compensatory Cost is being recognized as the services are rendered; its balancing entry is the Equity Net Worth, in an account of non Capitalized Contributions. It is registered in this way, because it is assimilated to receiving cash before the issue of the shares and does not foresee reimbursing the availabilities, it is taken as a payment to the capital instrument that will be issued in the future, i.e. when the options yield. When exercising the option of non Capitalized Contributions they become Capital - quantity of shares for their face value -, the difference between the face value of the share and the strike price is imputed as Issue premium. Thus the Capital is without alterations, since although its quantity was increased, it also increased the number of shares. The Non Assigned Results diminish, what is translated into their capitalization in the quantity of the Compensatory Costs (Capital plus Issue Premiums).

A recognition alternative such as Liabilities is when one pays the employees in cash when liquidating the options, provided it has been specified in the options plan, this form of payment and it is the employee the one who decides to receive this form of payment. If the payment decision is made by the enterprise, it is considered as a capital instrument. The registration will be the accumulation of the Compensatory Costs in a liability account, and as Capital, the difference between the fair value of the option and the cash that is paid. That liability stops to exist when it is paid to the employees and the Capital remains in the Net Equity, as part of the capital instrument that the employees have yielded to the enterprise. If the employees do not decide to receive the cash, then the Liabilities are reclassified as Capital.

Now then, if the emission of a capital instrument to compensate the employees is not issued until the instrument yields, what happens if the employees lose the right to receive the capital instrument? The loss of the right can arise, for not having completed the requirement of rendering services (fixed plan) or because one did not achieve performance previously fixed (variable plan), or that the employee does not exercise his right of option because the strike price is lower to the market price. As the total Compensatory Cost that was recognized in the Financial State is representative of the number of effectively accrued instruments, a circumstance which we outlined, the original registers are reverted i.e. the Compensation Cost and the Capital, circumstance that we outline, the original registrations are reverted, that is to say it does not recognize the compensatory Cost and the Capital, since the norm does not allow to reverse compensatory Costs with countervalue to Revenues.

It is also allowed to use the, intrinsic valued method, as is pointed out by the Opinión N° 25 of the APB. The adoption of one or the other method is indistinct, but once one chosen, it will have to continue with the same one. This method of intrinsic value, Opinión N° 25 of the APB, is determined that it should differ from the fixed plans, in which the employees are not obliged a performance, from those that are variable that do condition the rendering of services on their behalf. For that rendering of services the enterprise, at the end of each fiscal year, should recognize the Compensatory Cost at quoted market price, of the issued shares deducing what the employee should pay for the purchase of said shares and, accumulating this cost for which the services are rendered. So that, when the options are emitted the quantity of shares to be bought, should be specified, the strike price and the periods in which the employees should render services. The same as in the fair value method, the result is that the utility is diminished as consequence of the registration of the Compensatory Cost netting with the Premium Issues and the Accounting Capital of the enterprise remains intact the same as the previous method.

2.3.2. At International level

As for the emission of norms at international level the, International Accounting Standards Boards, IASB, at present, International Financial Reporting Standards, IFRSs, through the NIC (International Accounting Norm) or NIIF (International Financial Information Norm), emit the professional accounting norms. Among them we researched the NIC 19 Benefits to employees, which demands to inform about the benefits granted in the Financial State, but it does not possess the requirement on their recognition and rating. Therefore, it can be inferred that it has not yet issued an application norm for the recognition of the realized payments to the employees based on shares. However and, due to the more and more frequent and voluminous use of this method of payments, some organisms transferred the concern to IASB and in July 2002 it developed a draft from a NIC that was published in November of that same year. In it, it expressed that the enterprises should recognize, without exceptions, in their Financial State all the payments based on shares, including the transactions that are paid in cash, in other assets or in capital instruments and transactions with employees and other parties.

In accordance with what has been enunciated, it should be accounted after the accrual of the services takes place, i.e. after the services have been rendered and to recognize it as a Cost. On the other hand, it distinguishes if the services are settled in shares, it will be incorporated as a capital increase (Capital instrument); or as passive if the transaction is based on shares paid in cash. The rating and recognition is carried out on the day in which the capital instruments are granted at fair value, without distinction if they are fixed or variable plans. That fair value is considered as equivalent to the total fair value of the services that the enterprise expects to receive during the period that the instruments yield, or which it hopes to receive. In the case of the granting of options, the fair value should be determined based on the market price of similar options, as to given terms and conditions. If it were not possible to place in the market equivalent instruments, that fair value is esteemed through the models of rating of options, as that of Black and Scholes' or that of Cox, Ross and Rubinstein's (binomial). For that one should keep in mind:

- The strike price of the option;
- The life span of the option;
- The current value of the share;
- The expected dividends on the share;
- The free risk rate during the expected period of the option; and
- The expected volatility of the price of the share.

Also, in a Note to the Financial State, one should expose the determination of the fair value of the capital instruments, and the effect of the Compensatory Costs as consequence of the payments carried out in shares, with the purpose that the Accountable States user understands their nature within the period.

2.3.3. in the Argentine Republic

In the territory of the Argentine Republic the emission of professional accounting norms is authorized by the Professional Councils of Economic Sciences (FaCPCE) in the twenty-four jurisdictions due to Law 20,488/73, a function that was delegated to the Argentine Federation of Economic Sciences Professionals Council, with the object of obtaining uniformity in the application of the norms in the whole country.

Said norms are of obligatory application for the accounting profession and at present they are called Technical Resolutions, RTs. Among them, Technical Resolution N° 18. "Professional Accountant Norms: development of some special application matters "and Technical Resolution N° 20 "derivative Instruments and covering transactions" which modifies RT 18, they are norms of special application. RT 20 treats - according to what it establishes in its Introduction - the entirety of the Derived Financial Instruments; this is with speculative ends and of covering. However, it is not applied for the entities that emit capital instruments that are classified within the Equity Net Worth. Although a figure called "capital instruments" appears, we should say that in no other RT is the capital instrument mentioned.

The fact of registering this capital instrument violates the conceptual framework and especially the capital to be maintained, since this is defined in RT 16 in 4.1.3. "The equity net worth and the participations of shareholders non controllers in the patrimonies of the controlled enterprises", when it expresses that the equity net worth is compound for the capital (it differs between assets and liabilities) coming from the contribution of the proprietors plus accumulated results. Incorporating an entry of the aforementioned nature, it implies to maintain results differed in said Patrimony, not allowed by the RT.

For what has been said, we can conclude that there do not exist norms that regulate the cost of the Purchase Option of shares of the same enterprise, as a recompense or salary incentive that are granted to the managers or administrators of the enterprises. In this situation, the issuing entity of the Accountable States can hide the launching of the Options until they are exercised, in case this happens. That is to say, not to register the accrual of the corresponding labor cost until that moment, which leads to increase the capital of the enterprise at the moment of the exercise of the instrument on behalf of the employees, and the corresponding adjustment to the results of previous exercises. From the point of view of the costs, the products and services conceived during the period of validity of the plans never impacted that labor cost in their unitary value, neither in the shares, which causes sub evaluations and distortion of the cost of the products and services in the Results State. If the Options are not being exercised, the user of the Accountable States never obtains information of the launching of the negotiated plans through this modality, and cannot make decisions as the norm seeks, when it says that the objective of the Accountable States is to provide information to facilitate the taking of economy decisions. Summing up, the true economic reality of the entity is not exposed.

3. Proposal

Our proposal consists in the first place on the necessity of emitting, on behalf of the accounting profession, FaCPCE, a normative body of the special characteristics that regulate the appropriate inclusion in the Accountable States of these operative ones.

In second place and, in a special way, keeping in mind that this kind of transactions is carried out with a lot of assiduity for the enterprises that operate in different countries - as consequence of globalization, we propose the registration at the moment of the launching of the shares purchase option, as a labor cost. In each one of the fiscal years it should register the accrual of the services, derived from the retribution to the enterprises' employees, with counterpart to a contingent liability account (provisions). AND:

- If the options are exercised: at said moment it should be considered as capital cancelling the contingent liability;
- If the options are not exercised: the accrual entry should be reverted and to register the results as recovery of costs, if it should be done, the results of the previous exercises have to be done.

The rating of the Stock Purchase Options of the enterprise itself has to be carried out according to mathematical models such as that of Black and Scholes' or that of Cox, Ross and Rubinstein' (binomial) - among others – these types of instruments not being quoted in the market, and in each exercise measure, the revision will be carried out at its value, which in consequence will give place to the registration of the results for the corresponding holding. If there exists a market value, this should be used, that is to say the current value will be used, a situation that is not always presented.

This proposal is inserted in the RT 16 respecting the adopted general model and the capital to be maintained - the financial -, because it recognizes passive and emergent results of the operative financial instrumentation and; specifically, in RT 17, 4.8 "Consideration of contingent

acts” every time there is the possibility of it occurring in the future and is not controllable by the issuer of Accounting States; but it is considered an existing fact on the date of its confection, with a high probability of happening in the future, and its quantification is possible in currency in an adequate way, i.e. for the value of the options in the amount given.

As for the information to be exposed in the Accounting States, as complementary information, one must reveal the issued Options with indication of the quantity of shares to be bought, the or the negotiated plans given to the employees and the period of rendering services, the maturity date of the Option and the exercise price.

From the perspective of the determination of the costs, the retributions represent accrued amounts of the services that the enterprise receives from its personnel, in this case the hierarchical one. For its characteristics we should classify it as a fixed cost, since it does not have a direct relationship with the activity level, in fact it is as a structure cost. They are costs that are accrued to produce an article (or several) or to render services, without physical incorporation to them, but there exists the necessity of its absorption as belonging to the support departments to the production. Finally, it should have incidence in each product or service. Due to their quantity, and for being remunerations of extraordinary character, they increase their unitary value in the periods in which the plans are granted.

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