**CL 223**

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I may have got the wrong end of the stick on this one, if so I apologise in advance, but it seems that FRED 31 suggests that if someone is granted options the revenue effect is based on the theoretical value of the options on the day they are granted and the not on the day they are exercised. If my understanding is correct then I disagree with this treatment and think it should be replaced with a method which reflects the value on exercise date.

My preferred method would be to make a charge each year based on the value of the options outstanding at the year end and to make a one off balancing adjustment on exercise date.

I can see that there is an argument which says that the cost to the company arises on the day of grant and that future events have no bearing on that cost. However I do not accept that argument as the true cost to the company is the gain made on exercise date and it is this cost, as a shareholder, I would like pinned down. If you take the scenario where a director is granted a huge number of out deeply out of the money options that have a low theoretical value and consequently only appear as a small cost in the accounts but subsequently the share price increases such that it enables the director to exercise those options and end up with a significant holding in the company for virtually nothing then the shareholders will have had the wool pulled firmly over their eyes which is precisely what the object of this FRED is intended to stop. Similarly it can work the other way round where in the money options are granted at a discounted price which would result in a charge on the date of grant however if the share price collapses and the options expire valueless then there is no write back to the accounts. Neither of the above scenarios gives what I would regard as a true and fair view.

Regards

John Gledhill