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From: RDMcDougall3@aol.com [mailto:RDMcDougall3@aol.com]
Sent: 06 March 2003 10:43
To: a.cooper@frc.org.uk
Subject: ASB Accounting Standards

Accounting Standards Board
100 Grays Inn Road
London WC1

4 March 2003

Dear Sirs

FRED 31

I am writing to you on the above as a director of a small quoted plc and chairman of its remuneration committee. Rather than answer your questions in 'invitation to comment', I would like to reply:-

1. The retrospective nature of the introduction seems extremely unfair. I can imagine that you might think that if it were not so, vast numbers of options would be granted before the gate closed. However, companies don't actually work like that and furthermore there are rules and limits which govern the issue of options generally approved by ABI and such other bodies.

We wish to issue following our 2002 accounts options to various executives at senior and more junior levels. We believe that this aligns the interests of management and shareholders more closely. We are unable now to do so since we are completely in the dark as to what the cost of such a scheme might be to our bottom line (there is of course no tax relief).

2. Crucial to the above is of course the valuation issue. There is only vague guidance. Our auditors PWC have given a figure of approximately 60% of the current share price as being the value of the option, but they are by no means sure, and this guidance depends upon a series of assumptions about the future which are by nature untested and uncertain.

In my earlier days there was a formula in existence which valued options on the basis of current price squared divided by (exercise price x 4). This would have given a value of 27.5% of the current share price as being the cost of an option. Furthermore, at least this would be a mathematical formula which remuneration committees could use in determining whether options could be issued.

Using the PWC formula appears to produce a deduction of 3% of PTP where the dilution factor is under 2%. This hardly seems fair.

3. Your question (2) asks whether other entities should have this treatment applied to them. I can see no reason why private limited

companies should be treated in this way. In general terms their shareholders are only too well aware what is happening and the financial penalties to the bottom line seem excessive.

4. ASB questions 3/4/5: I have no particular comment on these.

5. ASB question 6: I feel I have also answered this. I find the IASB questions rather difficult to grasp in concept as they seem to be dedicated to the USA.

6. I find the question of accounting for the charge extremely difficult. If conditions in Year 2, for example, alter for the worse, is the original provision to be written back? What accounting entries are to be used when an option is actually exercised? Surely any premium should go through the share premium account, which under British accounting is segregated from the P&L account. Of course since it is not allowable as a deduction for corporation tax the cost to the shareholders in earnings reduction is grossed up by 0.7.

In conclusion, I have to say that I agree with the chairman of NASDAQ that this is a flawed concept for the smaller companies such as ourselves who need to co-identify shareholders' interests with those of the employees.

Yours sincerely

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I am sending this to you by email having said that I thought it was not technically possible originally.