UKSA

The Editor,
Financial Times
London

by e-mail to: letters.editor@ft.com

15 August 2005

UK Shareholders Association Ltd

BM UKSA
London
WC1N 3XX

Phone: 0870-70-60-600
Email: uksa@uksa.org.uk
Web: www.uksa.org.uk

On Estimating the Costs of Share Options

Sir, we sympathise with John Pierce's concern that it is difficult to make a reliable estimate at the date of grant of the cost to shareholders of share options. We would much rather have an estimate than nothing, but are uncomfortable that the total ultimate reported cost should be a matter of judgement. It need not be.

The core of our argument is that the most meaningful estimate of the cost can and should be made at the earliest point of certainty, namely the gain made by the executive at the moment of exercising the options – whether or not he or she actually sells the shares. Being based on the share price at that time, this is the market's best estimate of the value transferred by the shareholders and of the cash the company would need to spend in the market to put the shareholders back to the same undiluted position they would have been in had the option not existed.

If the liabilities for past grants are restated to currently estimated values each year, until the options are exercised or expire worthless, the earnings will have to be restated to reflect the actual experience of share prices. The cost estimates made at date of grant would only persist for one year – some comfort to M Pierce, perhaps. It would ensure that the modelling process, Mr Pierce's "academic formula", would only impact the timing of the reporting of the cost of the benefit, and that the economic reality would be correctly reported in the end.

This is, in fact, how cash-settled share-based payment is accounted under the new international standard. We now believe this approach should have been applied to all share-based payments, whether or not shares are actually issued.

As share prices fluctuate, the values of outstanding options can fluctuate even more widely. Recognising this causes earnings to swing, albeit reducing earnings when prices rise and increasing them when prices fall. As shareholders, we believe such an approach applied to all share-based payments would give results that are closer to the truth.

Martin White

Director, UK Shareholders Association