

ikon

Letter of Comment No: 2508
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From: Stacey Sulay
Sent: Tuesday, May 18, 2004 9:57 AM
To: ikon; Karen Salmansohn
Subject: FW: FAS 123 is fundamentally flawed

-----Original Message-----

From: david.w.mcdaniel [mailto:david.w.mcdaniel@comcast.net]
Sent: Tuesday, May 18, 2004 9:57 AM
To: Stacey Sulay
Subject: FAS 123 is fundamentally flawed

I work for a company and have benefited from stock options; I've exercised and held, so I *am* a stockholder.

In any case, my issue with FAS 123 is that it is fundamentally flawed as currently proposed.

The problem is that FAS 123 proposes to expense what is fundamentally *not* an expense. An option is not an expense when issued, it is a *potential* expense; it is a liability and should be reflected on the balance sheet, not the cash flow statement.

Consider the obvious. My company issues me options but they don't vest for five years. I leave after three. The company has recorded an expense which was never in fact incurred. And even if the rule allowed the company to reverse the expense at the future date, it would still be wrong. If it reversed in the amount recorded as an expense initially, it wouldn't reflect the then current value of the option. Or it could reverse and market value; that's even more sublimely ridiculous since it puts the company in the position of speculating in its own currency. Surely this is the kind of gaming that is subject to abuse.

I believe my proposal is more equally or more transparent, and fundamentally more correct in the economic sense. I propose that options, when granted, should result in reserve set aside on the balance sheet just like any other recorded liability. This reserve amount should be adjusted no less frequently than quarterly to account for the change in value of the underlying value of the option, plus adjustments for options exercised.

Consider the effect of this. My company issues an option and records a liability. If the stock price goes down, the liability shrinks on the balance sheet. If the stock price goes up, the liability grows. I submit to you that this in itself would have a healthy dampening effect on the market. In any case, if the stock goes up and I quit, the company gets to reduce the liability amount by the value of the unvested options. If I exercise, the company can reduce the liability, record an income item for the price I paid, and (if you insist) be required to purchase shares on the open market to fulfill the exercise, thus being forced to record an expense then. I would prefer the rule to allow the company to fulfill the exercise from previously purchased or issued shares. In this way, shareholder dilution does *not* occur, and expenses, if they are incurred at all, are properly recorded when they occur and at a real, not estimated, cost.

I respectfully request that you reconsider and rescind this exposure draft, and replace it with one whose mechanics properly result in reporting economic fact, such as my proposal, instead of fiction, as is the case with the current proposal.

Regards
David McDaniel
PO Box 227243
Dallas, TX, 75222
david@mcdaniel.name