Stacey Sutay

Letter of Comment No: 2680 File Reference: 1102-100

Subject: FW: Stock Options - Comment letter

Director of Major Projects and Technical Activities 21 May, 2004

FASB

401 Merritt 7

Norwalk, CT 06856-5416

Dear Sir:

As a small investor, I have been concerned for some time by the deluge of options being granted by some public corporations whose shares I own, seemingly without regard to ultimate cost, except perhaps for Berkshire Hathaway and Coca Cola.

A concept for expensing stock options on a simple and practical pay as you go basis occurred to me; it would provide accurate reporting of their TRUE value and CURRENT IMPACT ON THE BOTTOM LINE (with a time lag no greater than three months). That "expense as you go" concept is summarized below:

1. On the reporting date of the first quarterly corporate report following a stock option grant, the grantor corporation converts the options to "phantom equivalent" book-entry shares, the number and value of such phantom shares being based on the reported closing price of common shares traded on that date, less the option price, and the equivalent cash value of those phantom equivalent shares is shown as an expense item on that quarterly income statement. The expense reporting for those "phantom equivalent" shares on subsequent quarterly income statements is adjusted upward (as additional cost if the equivalent value increases), or downward (as income, if the equivalent value previously expensed decreases); this process continues until the date when the options are exercised. Such an "expense as you go" concept eliminates the need to report

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"diluted" earnings for those "equivalent" shares as is currently done.

2. When the options are exercised, if they are converted to cash on the exercise date, the payout is expensed on the income statement of the next following quarterly report, but that cost is adjusted for all prior expensing; the payment by the corporation is taxable to the recipient as ordinary income. If converted instead to real book-entry shares (i.e., no longer phantom shares), the corporation uses the cash value to purchase real shares on the open market via a brokerage, the number of such book-entry shares being based on the closing price on the exercise date, and the purchase cost is expensed, with such cost (or income) adjusted for prior expensing. For tax purposes, such book-entry shares have zero cost basis; if and when sold by the recipient at some future date, they are taxed to the individual owner as capital gain, but there is no capital loss if options expire unexercised.

## ADVANTAGES OF THIS CONCEPT:

The true market value of options and their cost to the corporation is reported on corporate income statements, with only a three month delay (worst case). The uncertainty and ambiguity of reporting "diluted" earnings is eliminated.

By recognizing fairly quickly the real cost to the bottom line, perhaps greater care will be taken in issuing "freebie" options. With book-entry shares taxed at the capital gains rate when sold at a future date, there may be greater incentive for key personnel and corporate officers to hold shares for future gains. Because book-entry shares are purchased by the corporation on the open market, there is no change in the number of issued shares, nor "dilution" for other shareholders. Book-entry shares can be transferred, if desired, to the beneficiaries' personal brokerage accounts at no cost.

## EXAMPLE:

Quantity 1000 options are granted to John Doe at a price of \$7. On the date

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of the subsequent quarterly report, the closing price of ordinary shares is \$8.

The income statement shows expense of 1000X(\$8-\$7) = \$1000. The number of phantom shares is \$1000/\$8 = 125.

On the reporting date of the next two quarters, there is no change in market price of shares, so there is no additional expensing.

On the next reporting date, the market price is \$9, indicating a \$2000 increase in value for the original grant. Because \$1000 had been previously expensed, this report will expense only an additional \$1000. The number of phantom shares is \$2000/\$9 = 222.22.

On the next reporting date, the market price is \$6. The previous expensing of \$2000 is taken as a gain. (There is no loss of \$1000 and there are zero phantom shares.)

Subsequently, the corporation wins a big order, the market value of shares increases to \$10, so John Doe exercises his options, takes \$1000 in cash and \$2000 in book-entry stock, the stock having been purchased for him by the corporation on the open market. For tax purposes, he must report the cash he receives as ordinary income, and if he eventually sells his 200 shares of stock, he must report a zero cost basis for the sale. On the next quarterly report, \$3000 is expensed by the corporation. If John Doe requests it, his book-entry shares can be transferred to his existing brokerage account at no cost.

I would appreciate any comments or suggestions you may have.

Sincerely,

M. Robert Paglee, 863 Golf View Rd., Moorestown, NJ 08057; (856) 235-1626

PC: Warren Buffet, Berkshire Hathaway

Sincerely,

Bob Paglee, Sr.