

ikon**Letter of Comment No: 3208**
File Reference: 1102-100

From: Stacey Sutay
Sent: Monday, June 07, 2004 1:37 PM
To: ikon
Subject: FW: Mr Hertz.doc Expensing employee stock options CORRECTED

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

From: John Olagues [mailto:johnolagues@cox.net]
Sent: Saturday, June 05, 2004 2:00 PM
To: Pat Durbin
Subject: Mr Hertz.doc Expensing employee stock options CORRECTED

Mr Robert H. Hertz
Chairman FASB
C/o Pat Durbin
Norwalk Conn.
USA

June 5, 2004

Dear Sir:

After much thought, I believe the following is the best methodology to calculate and expense employee stock options.

This method recognizes the following objectives:

1. Transparency and Clarity and Accuracy
2. Uniformity
3. Consistency with other accounting principles
4. Simplicity.

FACTS

- A) When most employee stock options are granted, an employee/employer contract is created requiring future performance by both parties. Before the options vest, the employee merely has a right to receive an option to buy stock.
- B) After the options vest, the employee can now exercise at will, but is still required to perform into the future in order to achieve the full value of the options. Otherwise he may terminate or be terminated and the time remaining on his options is reduced, thereby reducing the value of his options.
- C) There are other factors that decrease the value of the employee stock options vis-à-vis listed stock options such as non transferability and the inability to pledge the options as collateral.
- D) Options (and rights to receive options) are favored on the other hand because employees are not at this time taxed on the options when granted or when they vest.

In recognition of the above objectives and facts, we present a method of calculating the value of the

6/7/2004

options for expense purposes only and setting the proper time to expense the value.

The method is a choice by the employer of X or Y:

X

- i) No calculation is made at grant day
 - ii) No expense against earnings is calculated at grant day
 - iii) After the options vest, a calculation by use of the Black Scholes model is made, reducing the full time remaining by an amount consistent with historical expectations of premature exercises.
 - iv) All values are recalculated quarterly
 - v) If it is desired to create a uniform manner to calculate volatility, the implied volatilities of the longest termed listed options with similar exercise and expiration terms can be used as a guide.
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Y

- Same as i), ii), iii), iv) above
- v) Assumed volatility is "zero"

These two methods align the reported expenses when partial performances are carried out by the employee and awarded by the employer.

Choice "X" will always show a value equal to or greater than "Y" and perhaps is more accurate. Method "Y" dispenses with the uncertainties of what the best volatility assumption should be and creates uniformity and simplicity in the calculations.

Sincerely

John Olagues