## ikon From:

Letter of Comment No:2905 File Reference: 1102-100 Jim Middleton [jim.middleton@Sun.COM]

Sent:

Tuesday, June 01, 2004 12:57 PM

To: Director - FASB

Subject: File Reference No. 1102-100

Director FASB,

I am writing to point out some significant deficiencies in the rules proposed regarding the expensing of stock options.

- Current models grossly overvalue, and therefore penalize, broad-based employee stock option plans. The Black-Scholes and binomial models advocated by FASB for valuing options at grant date do not take into account their unique nature. In particular, FASB has not fully taken account of the fact that these options are are: nontransferable; cannot be hedged; are long-term with typical vesting periods of four years and exercise periods of 10 years; generally forfeited if an employee leaves the company or is terminated prior to vesting; and, most importantly, that no market currently exists for trading employee stock options.
- The FASB has not permitted any means to "true-up" an expense in later years. For instance, in July 2000 Sun Microsystems granted options that under Black-Scholes modeling would have resulted in a \$647 million hit to its bottom line. All these \$45.09 options are now deeply underwater, yet under the FASB proposal Sun would have no opportunity to correct, or true-up, its financial statement.

If expensing of stock options is going to be required, the method of valuing them must reflect reality. The initial expense must fairly value the the options given the above mentioned limitations to employee stock option plans. Also, this valuation must be updated, and corresponding positive or negative expenses applied, as events occur such as fluctuations in the price of the stock, early departure of the employee which renders unvested options worthless, etc. Otherwise, American corporations will lose a tool which not only incents people to take a job with it in the first place, but also incents them to put in their best effort while on the job in order to maximize the value of their options.

Sincerely,

James S. Middleton

Jim Middleton Systems Engineer



jim.middleton@sun.com phone: (614) 341-2466 fax: (614) 224-5211 cell; (614) 327-5450

495 S. High St. Columbus, OH 43215

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