

Stacey Sutay

Letter of Comment No: 37
File Reference: 1101-SCU
Date Received: 03/16/03

Subject: FW: Stock Option Accounting

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

From: gibraltar@netzero.com [mailto:gibraltar@netzero.com]
Sent: Sunday, March 16, 2003 11:19 PM
To: Robert Herz
Subject: Stock Option Accounting

From: Andrew
201 Country Club, Apt. 524
Rio Rancho, NM 87124

Dear Mr. Herz;

I would like to offer the following as a possible starting point for finding a solution to Stock Option Expensing:

1. A company should have to set up a fund for holding stock option shares if it wants to give stock options to employees or anyone else! Hereafter this will be referred to as the Stock Option Account.
2. At any time that a company gives stock options to somebody, it must have a number of shares in the Stock Option Account that is equal to or greater than the amount of stock options outstanding (including the ones being granted). If the Stock Option Account doesn't have enough shares, then the options cannot be granted.
3. The company must expense any shares that are placed into the Stock Option Account with the actual cost of the shares (not some future predicted cost). It would also be a good idea to make the company purchase them as opposed to allowing the company to just create them.
4. The company cannot remove shares from this account except for the purpose of fulfilling exercised options.
5. When an option is exercised from this account the amount of money the person pays to exercise the option would be seen as income for the company (since buying the shares in the first place was an expense). As an alternative, the money could go straight into the Stock Option Account and be used to purchase more shares.
6. Expired options (or those forfeited by leaving the company, etc.) would leave the shares for those options in the Stock Option Account. These would presumably be used for covering future options. In no event should the company be allowed to pull the shares out of this pool except to cover exercised options.
7. An alternative to leaving the stocks related to expired options in the Stock Option Account might be to allow the company to retire them, much the same way as with a stock buy-back program (but don't allow the company to realize any gains from this action other than reduction of stock dilution). This should only be allowed if the company stops all stock option compensation (to employees as well as outsiders) and specific rules should be in place to limit how many years after doing this a company must wait before it can again begin compensating with stock options. I wouldn't want this Stock Option Account to be a way for companies to circumvent the usual stock buy-back rules (even though I don't know of any, companies would probably find one).

I understand that the above is rather basic and crude but I hope it might give some extra ideas as to how to handle stock option expensing. A grandfather clause might have to be inserted to not force companies to purchase stocks to cover currently outstanding options but that is for the experts to discuss. I know that you are very busy but I hope that this might help in some small way.

Sincerely,

Andrew