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From: RichardBradford [richardbradford@alum.mit.edu]
Sent: Tuesday, April 20, 2004 10:23 AM
To: Director - FASB
Cc: RichardBradford
Subject: A Flaw in the rate used for Stock Option Expensing

I believe there is a fundamental flaw in the rationale for the current plan for stock option expensing. I agree the employees are being awarded something of real value and that should be accounted for.

Let's take the case of a thousand shares of stock at 20\$ a share with a ten year vesting period. What the company has done is to loan the employee \$20,000 of stock for up to ten years interest free.

The expense to the company should only be the cost of that loan. The loan should be calculated according to the prevailing rates for a loan of equal risk to the lender. This begs the question, what is the risk to the lender? I would answer, that it is an unusual case of either zero risk or negative risk to the lender.

The lender in this case reserves the shares under option at the time the grants are created. Afterwards there are only two possibilities. Either the employee will exercise the options or he will not.

If the employee does not exercise the options, then the shares remain with the company and the interest the company would have subsidized does not have to be paid. This is a negative risk - the company gains back the interest it agreed to pay.

If the employee does exercise the options, then the employee agrees to pay for the shares which were set aside when the option was granted. In this case the company will have finished the capital loan and will be paid the full amount of that capital, so all it is 'out' is the interest on that guaranteed loan.

A perfect example of a guaranteed loan of capital is a federally guaranteed Mortgage. When a company supplies a mortgage under these conditions, the only factors of concern are the interest rates. The lenders balance sheet is not affected by how much the properties of the home-owners appreciate or depreciate. The value of the home belongs to the home-owner, not the lender.

Given that the risk to the company is so small, the interest rates for these loans should be expensed accordingly. A federally guaranteed ten-year mortgage in today's market would be in the 3-4 percent range.

I believe this interest-rate compromise meets the needs of investors and allows companies to account for stock options in a realistic way.

Sincerely,
Richard Bradford