



Mr. Michael Tovey
Manager - Stock Based Compensation Project
Financial Accounting Standards Board
401 Merritt #7
Norwalk, Connecticut
06856-5116
203-847-0700(0)

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Letter of Comment No: 86
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Dear Mr. Tovey:

I'm directing this "letter of concern" to your attention re. the project's consideration of the merits of expensing stock options. In short, I strongly support expensing stock options when the option is exercised. I suggest that the project avoid complicating the issue with such devices as the Black-Scholes model, or using inferred, intrinsic, or implied derivations of value - all of which are based on shifting sand, conjecture, and red-herrings. I offer the following rationale.

The cost of a stock option can be determined quite directly and accurately; and that cost should appear as an expense on the income statement of the granting corporation. The simplest and most direct approach is described below, given the following information:

EVENT 1: An executive receives an option to purchase a share of corporate stock at \$20.

EVENT 2: The corporation has in its treasury a share of stock previously purchased at \$20. (Unissued par or stated value of a share does not damage the point being developed.)

EVENT 3: The executive exercises the option when the market price per share is \$32.

At EVENT 1, no entry is made in the corporation's accounting records, except to note that an option was granted at \$20 per share to the executive. (See additional comment at end.)

NO EFFECT!

At EVENT 2, an entry is made to recognize the purchase of the share at \$20. The cash account is decreased \$20, offset by a charge to the treasury stock account. *i.e.*,

Dr. Treasury stock (an owners' equity account on the balance sheet)	\$20
Cr. Cash	\$20

At EVENT 3, two transactions occur:

(a) The executive pays the corporation \$20 when the option is exercised, and the treasury stock account is relieved of the \$20 charge made in EVENT 2. *i.e.*,

Dr. Cash	\$20
Cr. Treasury stock	\$20

The NET EFFECT of EVENTS 2 and 3a is ZERO!

(b) At the time of exercise, the corporation sold a share of stock to the executive for \$20 when it could have received \$32 by selling it on the open market. In short, the corporation incurred an OPPORTUNITY COST of \$12, (\$32 it could have received if sold on the market, less \$20 it actually received from the executive). This \$12 differential should be reflected as an expense on the income statement, offset by an increase in the owners' equity account Paid-in Capital in excess of par or stated value. *i.e.*,

Dr. Executive compensation expense (on the income statement)	\$12	
Cr. Paid-in Capital in excess of par or stated value		\$12

It might be advisable to add a footnote to financial statements when an option is granted to make transparent that "X number of shares were granted on Y date at price Z to various corporate employees." Such explanatory footnote would advise shareholders and financial analysts that a possible contingent liability (in the form of an opportunity cost) could confront the corporation in future, and that current shareholder equity may suffer some undetermined amount of dilution.

Under this approach, when the option is exercised, notice is clearly provided on the income statement that shareholder equity has suffered some dilution due to the corporation selling stock to an employee at a price below the market price at which a non-employee could have purchased the stock.

Feel free to contact me at my home phone 610-865-3417, or via e-mail: jbh1@lehigh.edu

Sincerely,

