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Letter of Comment No: 224
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MP&T Director—File Reference 1102-001
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

RE: Invitation to Comment: Accounting for Stock-Based Compensation

In the process of setting proper accounting standards, I believe it is highly useful to use the concept of symmetry. Thus if a *lessor* reports sales treatment on a lease, symmetry dictates that the *lessee* should treat the transaction as a purchase transaction. Likewise, if one party to a derivative transaction reports a *positive* result, symmetry dictates that the other party to the transaction should report a *negative* result.

This common sense concept is even used extensively in the U.S. Internal Revenue Code. For example, if a seller has a taxable transaction on the sale of its business, the buyer automatically receives step up (or step-down) in basis treatment of the transaction (a purchase transaction). Likewise, if the transaction is *not* taxable to the seller, the buyer *cannot* change the basis of accounting for the assets acquired for income tax-reporting purposes.

In stock option accounting, symmetry holds that if a corporation were to report stock option expense, the stock option holders (whether they are employees or even another corporation) would theoretically have a corresponding amount of compensation income. Economically, however, stock option holders do *not* for a second believe that they have been compensated unless their stock options are "in the money." At start-up companies, employees often work enormous hours. If a start-up company files for Chapter 7 bankruptcy protection and thus goes out of business at, say, the end of its third year, the employees holding these worthless stock options could never be convinced that they had been compensated from their stock options (even though the corporation would report stock option compensation expense).

In these situations, having the start-up company report compensation expense for three years makes little sense. Thus reporting stock option expense fails the symmetry test in situations in which the stock options become worthless to their holders. So much for the idea of reporting compensation expense in all cases.

An additional reason for not reporting stock option compensation expense (regardless of whether the stock option holders exercise options and make money on them) is that such expenses will never require the outflow of cash. Why allow something that will never result in a **cash outflow** to be reported as an expense?

I cannot imagine the FASB ever allowing something to be reported as revenues if it did not eventually result in a **cash inflow**. Under current GAAP, a corporation that holds stock options--whether the options are "in the money" or "out of the money"--is not allowed to report Stock Option Compensation Income (which would be a noncash credit)? Income recognition occurs only upon sale of the stock.

The corporation has no cost. The sacrifice that occurs if stock options are exercised is that a portion of the future earnings stream is forfeited and thus accrues to the employees who exercised their stock options. It is the dilution of the future earnings stream that should be measured and reported--not some estimated opportunity cost that means nothing to either the stock option holders or the owners of the company.

In summary, I believe that no amount should be reported in the income statement for stock option compensation expense as set forth in FAS 123.

Very truly yours,

A handwritten signature in cursive script that reads "Arnold J. Pahler".

Arnold J. Pahler, Lecturer