

Stacey Sutay

Subject: FW: Stock Option Proposal (File ref# 1102-100)

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

From: Director - FASB

Sent: Monday, April 19, 2004 9:29 AM

To: Stacey Sutay; Karen Salmansohn

Subject: FW: Stock Option Proposal (File ref# 1102-100)

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

From: Lee Adair [mailto:ladair@ultratech.com]

Sent: Friday, April 16, 2004 8:38 PM

To: Director - FASB

Cc: Lee Adair

Subject: Re: Stock Option Proposal (File ref# 1102-100)

I am a VP of Finance at a public company. However, I am writing this to you as an interested citizen, not as a representative of my company.

I am a proponent of measuring employee stock options as an expense that impacts the Company's profit and loss statement.

That having been said, the FASB should consider an objective measure of the true cost to stockholders. That measure should be fair to all companies, employees and shareholders.

I don't believe that volatility measures have any place in the accounting world. Although extremely compelling from an intellectual standpoint, I predict they will ultimately render the financial statements less useful.

Also, assumptions as to holding periods and employee turnover should be standardized - as these are variables that are far too difficult for mere mortals to estimate. The benefits of this standardized approach would far outweigh any perceived inaccuracies. Please just give us a period of time to add on to the vesting date and a national average for turnover.

[I suspect that economic arguments will fall of deaf ears - and I presume you realize that present valuation methods will lead to the defeat of options in those areas where they are needed most. Small-cap companies hoping to transition to large-cap status will hesitate in granting options - because the values assigned don't come close to reflecting the perceived benefits received by employees. Shareholders will over-emphasize the cost assigned to options and will reduce investment.]

Here is my proposal to address the issue of volatility:

For all options authorized by the shareholders, break the option grant cost into two components: (1) the true dilutive impact to the shareholders' stake in the company and (2) the above-market rate, or "upside," possible from the partnership that has been formed between the stockholders and the employee.

Definitions and accounting treatment of components:

True dilutive impact: I define this as the difference between the option's strike price and the risk-free interest rate adjusted price (to the point of vesting or the anticipated date of exercise). For example, if a company issues options with five year cliff vesting at a strike price of \$15/share, the risk-free adjusted price (using a 5% return) would be \$19.14. The deferred expense recognized at the time of grant would be \$4.14 per share - to be recognized on a straight-line basis over the vesting period.

Upside potential - In theory, this is the price appreciation that the shareholder is willing to share with the employee if above-market returns are achieved. This would be viewed as an "opportunity" cost, not something that belongs on the P&L statement.

The above approach recognizes that the arrangement between the shareholders and an employee is fundamentally very different than that of a speculator in options.

If you have read this far and have had a laugh at my expense, imagine the humor I have derived from trying to apply your possible valuation methodologies.

As an employee, I am fascinated by the values assigned to options that I have been awarded. Many employees will be happier with a small fraction of that value in cash - and they will get their wish.

From a stockholder point of view, I would rather have a logical expense assigned to these options (measuring the dilution at risk-free rates over either the vesting period or the expected holding period) and see the potential dilutive effect of extraordinary equity returns more effectively presented - perhaps even in a table on the face of the P&L.

One final shot:

If a company pegged the strike price to these risk-free returns, in theory they would have no book expense. There is a certain symmetry in this - as the employee would, in turn, only make money if stock returns exceeded market rates. Shareholders would only suffer dilution if returns exceeded what the market had anticipated - and I don't believe they truly view this equity-sharing portion of the stock gain as anything other than a shared opportunity.

Please, please give me something that I can measure. Something I can defend. Something that has some economic reality behind it. Something that will not have so many unintended consequences.

Finally, I believe the accounting profession is trying to step into the world of analytics with this proposal. If we try to be all things to all people, the financial statements will collapse under their own weight. Give people the information they require to make sound investment decisions. Not all of this information belongs on the P&L.

P.S. Do you really think that recognizing 50% of the imputed value of a 50-month, level-vesting option in year one is the right answer? I know how it works, and my company has applied this methodology to its footnote presentations since FAS 123 was issued. Its another compelling calculation that results in the wrong answer. It ignores the continuing retention value of options to employers after options become vested (even in-the-money options) and also ignores the fact that, hopefully, you have some real intrinsic value in the later vesting years (making them worth far more to employees). Perhaps the assigned expense values should be reversed?