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Sent: Monday, November 11, 2002 6:16 PM

To: Director@FASB.org

Subject: Accounting for Stock-Based Compensation

To: Director, FASB From: Anthony Gray

Subject: Accounting for Stock-Based Compensation

I am a self-employed computer software consultant with no financial self-interest in the outcome of any proposals about accounting for stock-based compensation.

I think it is ill-advised, counter-intuitive, and probably counter-productive, to treat stock options as a corporate expense. Unless the company buys back stock for the options plan, the issuing of options does not cost the company any cash, except for administrative expenses. If an option expires unexercised, then there is zero effect on the company and the shareholders. If an option is exercised, it dilutes each stockholder's share but still does not cost the company any cash - in fact, it brings in cash. There is certainly an impact (dilution) to shareholders, but not an expense to the company. From the company's point of view, stock options, if exercised, seem to me very similar to secondary stock offerings. The fact that the new stockholder(s) are employees doesn't change the financial impact to the company.

One argument I have heard for treating options as an expense goes something like this: options are a form of compensation, and compensation is an expense, therefore options should be treated as an expense. I disagree with this reasoning. Options are a form of compensation, but they are different from most other forms and should not be treated as an expense. Suppose that a company were to negotiate discounts for some employees from a local gym or automobile dealer or the like. This is a form of compensation, but I doubt that anyone would consider it an expense.

The other options issue attracting public notice is the fairness of distribution - is most of the benefit going to the CBO and maybe a few other top managers, or is it being distributed more widely. This is a vital matter but not primarily an accounting issue. I will address it further below.

In order for shareholders to evaluate the possible effects of a stock option plan, they need to know the following, which should be required in the company's financial reports.

- 1. By numbers of shares, how many options were granted during the reporting period at each exercise price, how many unexercised options were outstanding at the end of the period at each price, and how many shares (total, not just from previous options) are already outstanding. This will allow stockholders to estimate the potential future dilution of their shares.
- 2. By numbers of shares, how many options were exercised during the reporting period at each exercise price. This tells stockholders the actual dilution, and the income to the company.

 Who is receiving the options grants, by level within the company, number of shares, exercise price. This lets stockholders evaluate the fairness of the program.

Regarding the fairness of options grants, my strong preference would be to de-emphasize stock options in favor of profit sharing plans, for several reasons. The main reason is fairness - profit sharing plans benefit everyone in the company, not just a few top dogs who are already reaping the lion's share of other benefits (if you will pardon the mixed metaphors). Another reason is that the company's stock price is influenced by factors other than the company's performance (e.g. the general market climate and the market's ever-changing opinion of the sector), so the benefit to option recipients is not based solely on the company's performance. The profit sharing plan is much more closely tied to the company's performance. If stock options are still used, they could be required to pass a non-discrimination test similar to the one used in 401(k) plans, to insure that the benefits are not given disproportionately to a few top executives.

Shareholders are supposed to be the owners of the company, and therefore entitled to know all significant information about the company. Top management always pays lip service to the primacy of the shareholders, but in practice often considers shareholders a nuisance to be ignored or misled as much as possible. In my opinion, that's the first thing which must change, and part of it can be done by regulations requiring the disclosure of more information to shareholders. Of course shareholders have to get more diligent too.

I would like to add one more comment, on a unrelated matter. One of the next major corporate accounting scandals waiting for more public awareness concerns the unrealistic assumptions many companies are making about the future performance of their pension plan investments. I'm not even sure whether the assumption has to be reported. It's been commented on a number of times, and I cannot understand why there is no accounting rule limiting the assumptions to something reasonable (e.g. related to current Treasury Bond yields). The longer it goes on unchecked, the more traumatic the effect will be when companies are forced to face reality and adjust their earnings.

Thank you for offering a forum for public comment.

Sincerely, Anthony Gray 214 Anderson Avenue Closter, NJ 07624 201-767-8360