Dear Sir: Incentive Stock Option (ISO) gains comprise over 80% of executive compensation. However, most of this compensation is not accurately expensed on financial statements, because the Securities and Exchange Commission (SEC) allows corporations to use Fair Value pricing models that use management estimates to value and expense stock options (ex. future interest rates, stock volatility, etc.), instead of market prices on the Exercise date of the options (ex. The market price of the underlying stock minus the strike price of the corresponding stock options). This loophole in Generally Accepted Accounting Principles (GAAP) has impaired the integrity of financial statements, and caused executive compensation to balloon to over 275 times that of the average employee, because fair value pricing models price stock options much lower than market prices (ex. Facebook expensed their options at 6 cents each in 2012, when their stock was trading at over $42, resulting in a realized gain of over $20 per option at market prices). Therefore, I respectfully request that the SEC require corporations to expense stock options on their Exercise Date at the market price of the underlying stock, minus the strike price of the options, which represents the actual “realized gain” to executives who have exercised their stock options. Please note that corporations could still use a Fair Value pricing model, such as the Black-Scholes Model, to initially price stock options on their Vesting Date, if they are still “underwater” (ex. The market price of the underlying stock is less than or equal to the strike price of the option.) However, once the options are “in the money” (ex. The market price of the underlying stock is greater than the strike price of the option), they should be expensed on the income statement at the market price of the underlying stock, minus the strike price of the corresponding option, because this represents the actual realized gain to executives who have exercised their options, which should be recorded as compensation expense to insure the integrity of financial statements.

Furthermore, corporations are allowed to deduct the market price of the underlying stock, minus the strike price of the corresponding stock options, as compensation expense on their tax returns. Therefore, why shouldn’t they also deduct this expense from revenues on their income statements?

Therefore, in order to ensure the integrity of financial statements, I respectfully request that the SEC require corporations to price Incentive Stock Options on their Vesting Date using the Black-Scholes Model, if they are still “underwater” (or reprice them at market prices once they are “in the money”), and subsequently expense them on the Exercise Date at the market price of the underlying stock (minus the strike price of the corresponding stock option), once they are “In the Money” with an established market price.

Respectfully Submitted,

Richard Golladay/CPA