Dear Sir: Incentive Stock Option (ISO) gains comprise over 80% of executive compensation. However, most of these gains are 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 exercised options). This loophole in Generally Accepted Accounting Principles 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 use management estimates to price stock options much lower than market prices (ex. Facebook expensed their options at 6 cents each in 2013, when their stock was trading at over $42, resulting in a realized gain of over $20 per exercised option at market prices). Therefore, I respectfully request that the SEC require corporations to expense stock options at their Intrinsic Value on the Exercise Date of the options, which represents the actual “realized gain” to executives who have exercised their options. Please note that corporations could still use a Fair Value pricing model, such as the Black-Scholes Model, to initially expense stock options on their Grant Date. However, they should subsequently adjust this expense to Intrinsic Value at market prices on the Exercise Date of the options (ex. the market price of the underlying stock minus the strike price of the exercised options), similar to a proposal made by Harvard Business School in 2002.

Furthermore, corporations can deduct the market price of the underlying stock minus the strike price of exercised options as compensation expense on their tax returns. Therefore, why shouldn’t they also have to 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 requires corporations to initially expense Stock Options on their Grant Date using the Black-Scholes Model, and subsequently adjust this expense to Intrinsic Value at market prices on the Exercise Date of the options (ex. the market price of the underlying stock minus the strike price of the exercised options). This rule change will ensure the integrity of financial statements by expensing stock options at market prices, instead of management estimates.

Respectfully Submitted,

Richard Golladay/CPA

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