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Financial Accounting Standards Board
Attention: Robert Herz
401 Merritt 7
P.O. Box 5116
Norwalk, Conn. 06856-5116

Dear Mr. Herz:

I wrote the following letter in response to the enclosed article by Steve Forbes. Maybe you can consider my suggestions for stock option accounting.

I would like to point out several misconceptions in your article entitled, "Stock options? Leave the options open", which was in the Sept. 29, 2003 issue of Forbes Magazine.

You stated that options are a high-risk form of deferred compensation -"If all goes well, you'll be amply rewarded; if not, you lose out". This is not the case. If the stock price goes down, most companies just issue more stock options at a lower strike price. This is a double whammy to investors. In addition to the value of their securities going down, investors also have to suffer the dilutive effects of these additional stock option grants, which further decrease the value of their stock holdings.

You also stated that, "Investors have long been given, up front, fully diluted earnings, which are what profits per share would be if all options were exercised". Nothing could be further from the truth. Fully diluted earnings per share only takes into account the increased number of shares issued through stock option grants. However, it completely ignores the money spent by the company to buy back the stock from executives who have exercised their stock options. Earnings Per Share (EPS) = revenues minus expenses/number of common shares outstanding. Under current stock option accounting rules, to calculate fully diluted earnings per share, the denominator must be increased for the number of additional shares granted through stock options. However, the expense of buying back shares from executives after they have exercised stock their options is not deducted from the numerator as an expense. Instead, this expense is completely ignored in the EPS calculation. For example, if a company grants an employee a stock option with a strike price of $20 per share, and then buys this share back, either directly from the employee or on the open market through a stock repurchase plan, for $50 per share, the difference of $30 is not considered an expense under current stock option accounting, even though money was actually paid to the employee from retained earnings. This shenanigan inflates reported earnings per share, because the expense of repurchasing the stock is not deducted from revenues as an expense in the numerator. Essentially, the biggest part of executive compensation is not even reported on the income statement, and omitting this expense inflates the earnings per share calculation. This has resulted in hundreds of billions of dollars going into the pockets of executives ever since stock options were legalized over twenty years ago, at the expense of shareholders and employees. Instead of having that money available to shareholders for dividends or for employee pensions, it has been paid to executives through stock option grants and the subsequent stock repurchase plans, which use retained earnings to repurchase stock from an executive after he has exercised his stock options. This expense is not reported to investors on the income statement. Failure to report other expenses, such as salaries expense, selling, general & administrative expense, etc., as WorldCom did, would be considered fraud. Why then, do we allow stock option expense to be ignored?

You also made the point that there is no way to accurately estimate the value stock options, and that, "The current formulation will not allow companies to recover that expense if options go unexercised". This is also untrue. Companies are allowed a tax deduction on their tax return for the difference between the market price of the stock and the strike price of the option when the stock option is exercised, and companies regularly deduct this amount as an expense on their income tax returns, even though they are still allowed to ignore this expense on their income statements. I believe that this amount should also be deducted from revenues on the income statement just as it is on the tax return. If companies are required to report the expense of stock options to the government on their tax returns, then why shouldn't they also be required to report this expense to investors on their income statements? Even though the difference between the **strike price** of the option and the **repurchase price** of the stock is the most exact measure of stock option compensation expense, I believe that the difference between the **market price** of the stock and the **strike price** of the option should actually be used to calculate the expense of stock options, because this amount is already used to report stock option compensation expense on the corporate tax return, and it can be charged against revenues on the income statement immediately, instead of in the future, when the actual buyback price of the stock is known.

Furthermore, most companies combat the dilutive effects of stock options by instituting a stock repurchase plan, which is used to repurchase stock that was issued when executives exercised their stock options. These plans repurchase stock either directly from executives or on the open market at the fair market value. Therefore, the difference between the option strike price and the market value of the stock at the time the option is exercised is a close estimate of what the actual repurchase price will be in the future. Later on, when the actual repurchase price is known, an adjustment can be made to the financial statements to give the exact cost of the option expense.

At the end of your article, you stated that, "Business should have the freedom to offer options". Business will still have the freedom to offer options. However, they will now have to charge the expense of issuing stock options against revenues on the income statement, instead of just placing a footnote disclosure in the back of the financial statements. If a company issues a stock option to an executive giving him the right to purchase a share of stock for $20 per share, and the company then repurchases this same share of stock for $50, the difference of $30 must be charged against revenues as an expense on the income statement in order to ensure the accuracy of financial statements. Accounting for stock options as a compensation expense is critical to restoring the integrity of our financial markets, and it is only fair to report this expense to investors, employees, bankers and other parties who rely on accounting information to make investment decisions.

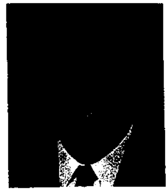
Concerned Investor,

Richard Golladay

FACT AND COMMENT

By Steve Forbes, EDITOR-IN-CHIEF

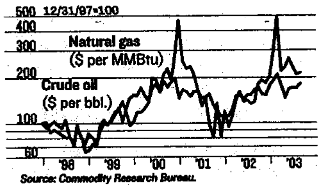
"With all thy getting get understanding"



The Economy Won't Run Out of Gas

WILL HIGH U.S. ENERGY PRICES—GASOLINE IS NEAR NOMINAL record levels—throw gear-grinding sand into the now-nascent recovery? Worriers fret that even if oil prices ease, natural gas will still be in short supply, and its costliness alone could crimp the recovery. In June Alan Greenspan gave vent to such a worry.

The answer: High prices hurt, but not enough to derail, or even seriously slow for long, the recovery train. Prices are, relatively, far lower than they were in the 1970s and early 1980s. They are overwhelmed today by the potency of 40-year-low interest rates, lower tax rates on capital gains, dividends and income, and the lavish liquidity now flowing from the Federal Reserve's dollar spigots.



As for natural gas, beneficial results could be achieved if Washington pressured OPEC to boost production and let petroleum prices fall. As this chart shows, although the prices of oil and gas can widely diverge, they don't do so for very long. If it's in the users' best interests, they can often find ways to substitute one for the other. Over time the costs of the two fuels closely parallel each other.

Iraq's finally gearing up to produce more oil will also help. And we could put additional downward pressure on oil prices by releasing supplies from our Strategic Petroleum Reserve.

In fact, next year the Administration should begin a serious campaign to destroy OPEC once and for all.

Stock Options? Leave the Options Open

RISK-TAKING IS THE ESSENCE OF FREE ENTERPRISE, THE ENGINE OF progress. Which is why the Financial Accounting Standards Board (FASB) should hold its horses and pull back from enacting a rule that would require publicly traded companies to expense stock options. The FASB's hope is that the "hit" to a company's reported earnings would effectively kill the device. In the aftermath of recent corporate scandals, the collapse of the high-tech bubble and the 2000-02 stock market crash, there is the perception that such a move would create more honest profit/loss statements and that somehow options helped create the high-tech binge and the lapse in business ethics of the late 1990s. Many large companies are already taking charges against their outstanding options on their income statements.

Startup companies, by definition, aren't going to attract top-level talent without the lure of that talent's being able to land a share of the gains if the companies hit the jackpot. Options are one way to do that. In this sense they are a high-risk form of deferred compensation—if all goes well, you'll be amply awarded; if not, you lose out. Sure, there were options abuses during the 1990s, but many of the egregious ones came from large, established companies that were the antithesis of new, high-risk startups. We don't ban stocks because equities can crash or be instruments for fraud. Full disclosure? We already have it. Investors have long been given, up front, fully diluted earnings, which are what profits per share would be if all options were exercised.

Established companies have far less need for options than emerging ones. That's why they can expense options while barely batting an eye. In July Microsoft decided to stop offering stock options to its employees, instead giving them actual shares, with certain restrictions attached. But if there's a new wave of high-tech startups, don't be surprised when Microsoft—now a multibillion-dollar blue chip, albeit a still highly agile one—once again offers options or some variant of them to attract and keep capable people.

By the way, if the FASB does decree that options must be immediately expensed, the current formulation won't allow companies to recover that expense if the options go unexercised. That is absurd, logically, as well as lacking consistency. How can a company take a charge for something and then not be able to reverse that charge if that something doesn't come to pass? But, of course, if the FASB were logical here, its desire to put the kibosh on options would be fully exposed as the absurdity that it is: that the worse a company's stock does, the bigger the boost to its bottom line.

And what formula should be used to determine this expense? Already, there are medieval how-many-angels-can-dance-on-the-head-of-a-pin debates about which method is most appropriate.

Businesses should have the freedom to offer options. The market, not the FASB, should sort out this issue.

Blow to Free Speech—And Free Enterprise

IN ITS MOST RECENT SESSION THE SUPREME COURT MISSED AN opportunity to shore up the First Amendment's protection of free speech and to put a crimp in the activities of extortionate, anti-free-speech trial lawyers. And the rest of us will pay the price.

The case involved Nike and its attempt to defend itself against attacks on labor practices in the overseas factories that manufacture