

FASB Holds Meeting with Valuation Experts on Stock Options

As part of its ongoing due process focusing on major current issues, on July 8 the FASB conducted a full-day meeting on the valuation of stock-based compensation. The productive session, which brought together the FASB and a distinguished group of valuation experts from various disciplines, was held at the FASB. In addition to the panel of outside experts, the IASB participated and Securities and Exchange Commission staff observed the meeting.

In an effort to gather key information measuring the fair value of employee stock options, the attendees discussed the differences between employee stock options and exchange-traded options and how those differences might impact the valuation of employee stock options.

Other subject matter that was discussed, tapping the expertise and opinions of the participants, included: vesting conditions; transferability; option-pricing models, their suitability and selection; estimation of volatility; nonpublic enterprises; reload options; and restricted shares versus restrictions on option exercise.

A major finding supported by the participants was that employee stock options could be reliably priced. While there was consensus belief that stock options could be valued, the group did not support a “one-size-fits-all” valuation method. Participants believed that because there are multiple factors that may vary from company to company, and across industries, the valuation approach should take those factors into consideration.

The group of experts concluded that while the Black-Scholes model has its merits, changes to the status of employee stock options (including forfeitures), interest rate fluctuations and stock price volatility would be better captured in a binomial (open-form) approach that allows for variability and adjustments to those types of considerations.

The Option Valuation Group comprises professionals from across multiple disciplines—academia, employee benefit consulting and investment banking. A list of group members and their affiliations follows:

Frederic W. Cook, Frederic W. Cook & Co.

John Finnerty, Analysis Group, Inc.

*Ravi Jagannathan, Kellogg School of Management,
Northwestern University*

David Larcker, The Wharton School, University of Pennsylvania

*Timothy Luehrman, Standard & Poor's, Corporate
Value Division*

Cindy Ma, National Economic Research Associates

Eric Reiner, UBS AG

*Stephen Ross, Sloan School of Management,
Massachusetts Institute of Technology*

Paula Todd, Towers Perrin

The FASB will take the Group's viewpoints into consideration as it addresses the subject of valuation in its meetings in September.