



# Fountainhead Forum

Issue: Volume I # 4

August 2009

**Dear Nina,**

I hope this newsletter finds you well. This month we have a good variety of articles for your reading pleasure, from current news highlights to information on the challenges companies face when complying with FAS123R. We also have suggestions for in-state weekend getaways to help you stay cool. Have a great August and stay out of the heat!

## Which Came First?

*The Grant Date Value of the Employee Stock Options or the Fair Market Value of the Common Stock?*

It's another one of those "which came first - the chicken or the egg?" questions. How can you determine the fair value of your employee stock options if a) the method you use to calculate the value of the options is based on the portion of the enterprise value allocated to the common stock, and b) the portion allocated to the common stock is a function of the value allocated to the options? In essence, each input is based on the other.

It's no secret that privately-held companies face challenges in complying with FAS 123R (valuation and expensing) and Sec. 409A (enterprise valuation) since there is no established value for their common stock. A recent article published by the National Center for Employee Ownership (NCEO), suggests a wrinkle in the interplay between the valuation of employee stock options (ESOs) and the dilutive effect on the underlying common stock, with the following considerations:

- To determine the value of ESOs for a closely held company, first determine the fair value of common equity, and then

## In This Issue

[Employee Stock Compliance](#)

[Microsoft Updates](#)

[The Fountainhead](#)

[AZ Weekend Adventures](#)

[News Highlights](#)



## [Contact Fountainhead Staffing](#)

Poke around in [here](#) a bit when the boss isn't looking. You might even learn something.

## [Trivia](#)

What spiked hair rocker sang "White Wedding"?

- Billy Preston
- Billy Joel
- Billy Swan
- Billy Idol

Bond, James Bond. This actor started his Bond career in "Live and Let Die" in 1973.

allocate that value between the common stock and the ESOs.

- The value of the options and the value of the common stock cannot be determined independently, with the remainder simply being allocated to the other. Because the value of each instrument is a function of the other, their values must be determined simultaneously.
- The value of each of a company's potentially dilutive instruments, including outstanding ESOs, warrants or convertible debt, must be included in the valuation of any new ESOs being granted.

For instance, if a company is valued at \$10M and there are 1 million shares outstanding, you can use \$10 per share when you calculate the fair market value (FMV) of the employee stock options to be granted. However, if you grant 100,000 options with a fair market value of \$3 per share (based on a BS valuation formula using \$10 per share for FMV and exercise price) and therefore allocate \$300K of value to the options, the FMV of the common stock has been reduced to \$9.70 per share. You could improve your valuation by re-valuing the 100,000 options based on a FMV and exercise price of \$9.70 per share. Then, you need to repeat the process until you narrow in on the best stock option valuation, taking into account the value of the options being valued.

The NCEO article summary explains that for a private company to accurately value employee stock options for accounting purposes, the company must use an option-pricing model that takes into account the dilutive effect the option exercise will have on the value of the company's common stock. For a private company, each time an option is exercised, the new shares that are issued dilute the overall value of other shares.

However, as the Journal of Accountancy points out, there is a precarious balancing act. "To correctly account for these interrelationships, all new and existing ESOs and the common stock must be valued simultaneously. Since most option valuation models require stock value as an input (as opposed to an output), these models should be modified to let both stock value and ESO value be determined simultaneously, with fair value of equity being provided as an input."

This commentary does not change the model that a company will use to value its new stock options under FAS 123R. However, it offers a new challenge when trying to determine the fair market value of the common stock underlying the options. Whichever valuation model a company uses, the dilutive effects of outstanding convertible securities, whether options, warrants or something else, should be kept in mind in the balance of valuation issues related to FAS 123R and Sec. 409A.

Who is he?

- a) Paul Jones
- b) Frank James
- c) Roger Moore
- d) Roger Brand

The Model T Ford was first launched in 1908 and was a massive success. However, Henry Ford was very attached to this particular model and waited quite some time before launching a new car. In what year was the Model A launched?

- a) 1919
- b) 1927
- c) 1922
- d) 1924

An astonishing 5 of the 8 best selling songs of 1978 were released by siblings with what last name?

- a) Osmond
- b) Gibb
- c) Jackson
- d) Ramone

(answers below)



Despite this or any future challenges, the conclusion remains the same: It takes professional judgment or a great deal of expertise to get it right.

By Gary Levine at [www.capitalizationmatters.com](http://www.capitalizationmatters.com)  
National Center for Employee Ownership [www.nceo.org](http://www.nceo.org)  
Journal of Accountancy [www.journalofaccountancy.com](http://www.journalofaccountancy.com)

## Personal Technology

### *Windows 7 is Coming in October*

The following excerpts are from an article written by Walter Mossberg that we thought might be of interest to you. For the complete article, visit The Wall Street Journal blog - [All Things Digital](#).

On October 22, Microsoft will finally release a new version of Windows that will be as good as the deeply disappointing Windows Vista should have been when it came out in January 2007. The new edition, called Windows 7, is a big improvement over both Vista and the sturdy, 2001 vintage Windows XP still widely in use.

But how will Windows users transition their current computers to the new Windows 7? While this latest operating system stresses simplicity, the upgrade process will be anything but simple for the huge base of average consumers still using XP, who likely outnumber Vista users. It will be frustrating, tedious and labor-intensive.

By contrast, if you're using Vista, the upgrade to Windows 7 should be a fairly easy, straightforward process. (Ed. Note: A small consolation for the frustration we early Vista adopters had to endure.)

But Windows XP users, including the millions who have recently snapped up cheap, XP-powered netbooks, will first have to wipe out everything on their hard disks in order to install Windows 7 on their current machines. In fact, Microsoft doesn't even call migrating to Windows 7 from XP an "upgrade." It refers to it as a "clean install," or a "custom installation." This disk wipeout can be performed manually, or automatically during the Windows 7 installation process.



"Government's view of the economy could be summed up in a few short phrases: If it moves, tax it. If it keeps moving, regulate it. And if it stops moving, subsidize it."

- Ronald Reagan

## Public Accounting Education Reports

The 27th Annual Professor's Survey (2008) ranks both Arizona State University and University of Arizona in the top 25 Accounting Graduate Programs.



Don't forget to attend your local chapter meeting!

**ASWA**

American Society of Woman Accountants

## Thank You, Ayn Rand....

We are often asked if our company name has anything to do with the book titled "The Fountainhead" by Ayn Rand. Well, not exactly, but the book did have an important influence. According to John Spencer, he and his wife were having a brainstorming session for possible company names. The search firm John used to work for was called Source Finance, and so John was trying to think of a synonym for "source". Just as he thought of the word "Fountainhead", his wife Kim blurted out "Fountainhead". (If you look up the word "fountainhead" in the dictionary, it is defined as "a principal source or origin," so it seemed like a perfect fit.) While the initial thought was to name the company Fountainhead Finance, they ultimately settled on Fountainhead Staffing.

Having said that, John and Kim are indeed big fans of other works of Ayn Rand as well, including her magnum opus, "Atlas Shrugged." We've included a synopsis and link for each of the books below.



### The Fountainhead

by Ayn Rand by Penguin Group USA

[Buy Now](#)

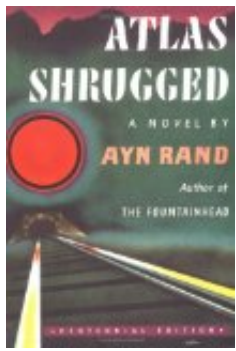


In 1943, The Fountainhead was author Ayn Rand's first major literary success and its royalties and movie rights brought her fame and financial security.

The Fountainhead's protagonist, Howard Roark, is an individualistic young architect who chooses to struggle in obscurity rather than compromise his artistic and personal vision. The book follows his battle to practice modern architecture, which he believes to be superior, despite an establishment centered on tradition-worship. How others in the novel relate to Roark demonstrates Rand's various archetypes of human character, all of which are variants between Roark, the author's ideal man of independent-mindedness and integrity, and what she described as the "second-handers." The complex relationships between Roark and the various kinds of individuals who assist or hinder his progress, or both, allows the novel to be at once a romantic drama and a philosophical work.

## Answers to Trivia

- 1) d
- 2) c
- 3) b
- 4) b



## Atlas Shrugged (Centennial Ed. HC)

by Ayn Rand by Dutton Adult

[Buy Now](#)



In 1957 Ayn Rand wrote her last article, Atlas Shrugged. This book explores a dystopian United States where leading innovators, ranging from industrialists to artists, refuse to be exploited by society. The protagonist, Dagny Taggart, sees society collapse around her as the government increasingly asserts control over all industry, while society's most productive citizens, led by the mysterious John Galt, progressively disappear. Galt describes the strike as "stopping the motor of the world" by withdrawing the "minds" that drive society's growth and productivity; with their strike these creative minds hope to demonstrate that the economy and society would collapse without the profit motive and the efforts of the rational and productive.

## Get Out of the Heat

### *Cool Weekend Adventures*

There are so many exciting and breathtaking locations to experience and explore in Arizona.....aside from the Grand Canyon!

### **Lynx Lake - Prescott**

This 55-acre lake is a fisherman's dream; stocked with rainbow trout and largemouth bass. Take a stroll on the Lakeshore Trail or have a picnic under one of the Ponderosa pines.



### **Moonlight Madness Shopping - Sedona**

Nestled in the red rocks of Tlaquepaque Village, savvy shoppers flock for one of a kind jewelry and art bargains. For one special weekend a year, Sedona's Main Street festival offers great food, kid-friendly activities, a free transit system, entertainment and more.

### **High Mountain Stables Horseback Riding - Mormon Lake**

Saddle up to the scenic trails of Northern Arizona with a guided tour letting you in on the history of the area. All skill levels are welcome.

## Lockett Meadow - Flagstaff



Surrounded by the rugged San Francisco Peaks and made up of the remains of an extinct volcano is a quiet valley known as Lockett Meadow. Hike the Inner Basin Trail where you will find brilliantly colored wildflowers, tall aspens and animals frolicking

along with you.

## Fiesta Septiembre - Wickenburg

Taking place the first Saturday in September, Folklorico dancers, mariachi music, salsa and margarita contests celebrate the town's Hispanic heritage.



## Camping - Anywhere!

Arizona offers many campsite locations; from the White Mountains to the Mongollon Rim. Where will your next point of exploration be?

## News Highlights



### *National*

**Dow tops 9,000 -**

**for the First Time Since January**

The Dow gained 188 points on July 23 to close at 9,069. The Nasdaq gained 47 to close at 1,974 and the S&P 500 rose 22

points to close at 976. Numbers released by the National Association of Realtors (NAR) helped Wall Street gain ground. The NAR said existing home sales rose to a 4.89 million unit annual rate in June, up from a revised 4.72 million annual rate in May and better than analysts' expectations.

Phoenix Business Journal - July 23, 2009

## **U.S. Recession to End in Q3; Speed of Recovery Uncertain**

The worst U.S. recession since the Great Depression will probably end in the third quarter, but there is uncertainty over the speed and duration of the economic recovery, according to the most recent survey of private economists.

This upbeat assessment followed recent government data showing that the gross domestic product (GDP) contracted at a shallow 1.0 percent rate in the second quarter after sinking 6.4 percent in the first quarter of this year.

Despite the improved economic picture, unemployment was likely to remain a problem, with the jobless rate predicted to peak at just over 10 percent late this year or early 2010, the survey showed.

[Reuters](#) - August 10, 2009

### **Consumer Spending Rises in June, Second Straight Gain**

The Commerce Department said that consumers boosted their spending 0.4% in June, slightly ahead of analysts' estimates. That comes after spending rose 0.1% in May.

Consumer spending is closely watched because it accounts for about 70% of total U.S. economic activity. The increase could provide a lift to the economy, but may be hard to sustain if incomes continue to fall.

[USA Today](#) - August 3, 2009

### **40-Hour Work Week Quickly Disappearing**

According to a new survey conducted by NFI Research, 77 percent of senior executives and managers worked between 41 and 60 hours a week. In addition, the study found that 52 percent of survey participants worked at least 51 hours a week.

Of the executives surveyed, 40 percent said they work at least 10 hours a day, while 20 percent said they worked 11 hours or more.

[Phoenix Business Journal](#) - July 28, 2009

### **Local**

#### **New Home Sales Surge in the West**

Sales of new homes in 13 western states, including Arizona, jumped 22.6 percent in June from the previous month, twice the national increase of 11 percent. In the West, it was the highest level of new home sales since last July.

[Phoenix Business Journal](#) - July 27, 2009

#### **Marked Drop in Crime in the Phoenix Metro Area**

A marked drop in Phoenix-area crime coincides with the recession and a drop in the number of illegal immigrants in Arizona.

Phoenix has seen a 25 percent decline in the number of crimes during the first five months of 2009 compared to the same time period in 2007 when the economy began to slow. Violent crime in Phoenix is down 12 percent, according to crime statistics from the Phoenix Police Department.

The Mesa Police Department reports a 19 percent decrease in total crimes for the first half of 2009 versus the first half of 2007, including a 10 percent drop in violent crime. Tempe has seen a 25 percent total drop.

At the same time, the state's illegal immigrant population has decreased by as much as one-third thanks to the down U.S. economy, tougher enforcement policies by the federal government and Maricopa County Sheriff's Office, as well as the state's employer sanctions law which goes after businesses who hire undocumented workers, said Steven Camarota, director of the Center for Immigration Studies.

[Phoenix Business Journal](#) - July 30, 2009

Keep in touch,

Fountainhead Staffing

