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Letter of Comment No: 5025
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From: French, T. Bondurant [BFrench@AdamsStreetPartners.com]
Sent: Friday, June 18, 2004 2:52 PM
To: Director - FASB
Cc: jcdowling@NVCA.org
Subject: Stock Options Expensing

Dear FASB Representatives,

I am the CEO of a private equity fund of funds, Adams Street Partners. We have been investors in private companies, directly and indirectly, for 32 years. We have cumulatively committed $16 billion dollars to over 8,000 privately held companies, mainly in the United States, but also in Europe and Asia.

I am very concerned about the recent exposure draft regarding the expensing of stock options, particularly as it relates to privately held companies.

There are many difficult issues related to stock options as demonstrated by the decades long debate on this topic. Employee stock options are in fact a hybrid accounting item that does not fit squarely on the income statement. My own view is that it is most properly accounted for on the balance sheet and not on the income statement. I do not believe stock options, particularly for privately held companies, should be expensed. Their "expense" is clearly in the dulition to the shareholders and should be highlighted on the balance sheet and in the footnotes to the balance sheet. Employee stock options do not create any liability or out-of-pocket cost to the company.

The expensing of stock options, particularly for smaller, privately held companies where the options are used widely, will make financial statements more difficult to read and compare. I do not understand how people can say expensing stock options will make financial statements more transparent. According to the latest exposure draft, if the "estimates" for stock options expense are wrong, the estimates are never "trued up." If FASB believes that companies should use "estimates" of value (like in depreciation schedules or pension costs), then one has to be able to rectify the estimates as the real "costs" are known.

The costs here, though, are different than other costs on the income statement. Stock options are really balance sheet items being brought into the income statement, which will create tremendous problems with income statement transparency as the stock market moves up and down. In effect, FASB is recommending that movements in the stock market (and the company's balance sheet) flow through to the income statement. This is insane.

For privately held companies, there is no easy way to value the options. The difficulty, complexity, likely inaccuracy, and administrative burden caused by the proposed methods of valuation (binominal method, intrinsic value method, etc.) will simply result in small, privately held companies not issuing such options. This will have a very detrimental impact on the ability of these companies to recruit, retain, and motivate key employees. The economic impact is likely to be significant as stock options have been a critical engine of entrepreneurism in this country. Seeing the success that the United States has had with stock options, India and China are now encouraging their use and are not requiring that these options be expensed. Why do we want to put ourselves at a further disadvantage to these growing powers in a global economy?

I would urge FASB to reconsider its drive to mandate expensing, particularly for private companies where estimates of volatility, exercise behavior (remember these options are restricted and nontransferable), and vesting make the valuation of employee stock options very difficult, and from a practical point of view, useless to all parties.

Please reconsider your recommendation to expense employee stock options, particularly for privately held companies.

Thank you,

Bon French