

Battery Ventures

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Letter of Comment No: 4810 File Reference: 1102-100

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Director of Major Projects
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Exposure Draft Regarding Share-Based Payments - File Reference Number 1102-100

Dear Director:

As the Managing Partner of a leading technology venture capital firm and as a board member of both public and private companies, I am writing this letter on behalf of Battery Ventures to express our concerns regarding the impact that the above referenced exposure draft ("ED") will have on our portfolio companies and venture capital investing. We believe the ED as proposed is inconsistent with standard accounting principles, and creates unnecessary administrative and expense burdens for both private and public companies alike. The reasoning for our beliefs is more fully described below.

Undermining the Use of Stock Options

Employee stock options are not a company cost because they do not meet the definition of an expense, which requires either the creation of a liability or an outflow of cash. We believe employee stock options represent a contingent reallocation of equity from shareholders to employees designed to reward employees for increasing the market value of a company by achieving positive financial results. Stock options are a significant factor in enticing enough talented employees needed to create a successful start-up company. In fact, venture backed companies have chiefly fostered the spirit of capitalism in this country and are responsible for creating and improving vibrant industries that result in a significant number of high paying jobs. We believe that the financial statement impacts associated with implementing and accounting for employee stock option plans under the ED proposal will severely limit the use of stock options for executive employees, and certainly will discourage or eliminate their use for non-executive employees. This will make it more difficult for entrepreneurs to attract, retain and reward a talented and dedicated staff, thereby jeopardizing a key factor in developing a successful start-up company.

Unnecessary Costs for Startup and Private Companies

Since no market for the purchase or sale of employee stock options presently exists, determining the current or expected value of an employee stock option is very difficult. Both valuation methods the FASB recommends, Black-Sholes and Binomial, require a significant number of estimates and calculations. These valuation methods are unreliable at best, as they apply to publicly traded companies where prior stock performance, volatility and exercise information is at least available. Non-public companies have very little or no stock trading history, making these estimates extremely difficult to



calculate, resulting in marginal if any, benefit to financial statement users. As a professional investor, it is our belief many such users will likely eliminate this information from any financial statement analysis they may perform, knowing the subjectivity, confusion and non-cash affects employee stock option valuations would represent. Unfortunately, most start-ups and other small businesses would be required to waste precious resources by having to hire additional staff or pay outside professional firms just to perform the complex calculations and valuations necessary for compliance with the ED proposal. More resources would also have to be spent on audit fees as auditors, valuation firms and clients debated the propriety of the valuation assumptions used, all done in pursuit of trying to get financial statements prepared in accordance with generally accepted accounting principles—something we value greatly as a professional investor in the start-up companies with which we invest.

Use of Private Company Financial Statements

Financial statements of privately held companies are extremely important to their ultimate end users, which include employees (and recruits), customers, vendors, local banks and investment firms such as ours. Requiring financial statements to include a material and subjectively calculated employee stock option expense will make financial statements less consistent, comparable and transparent while also making them more difficult for the less sophisticated user to understand. Even using the ED's alternative valuation method for difficult to value employee stock options, the intrinsic value method, would essentially result in variable accounting and leads to the possibility of significant and confusing non-cash financial statement write-downs and write-ups on a quarterly basis. Employees, customers and vendors need to be able to determine whether the company to which they are aligning their financial interest is profitable, generates positive cash flow and will be able to satisfy their obligations. Due to the amount of uncertainty surrounding the validity of whether stock options are an expense, much less applying an appropriate valuation methodology to determine the amount, we agree with the current practice of stock option disclosure via a footnote to the financial statements. This approach enables more sophisticated users to determine the dilutive impact on the net equity value of the company, while allowing other users to simply ignore the information and avoid becoming confused over the financial status of the company.

We recognize that the FASB has given these issues significant consideration over the better part of the last decade and has put a lot of work into reaching the conclusions included in the exposure draft. We urge the FASB however, to reconsider and withdraw the proposed changes as outlined, or at a minimum, exempt small, privately-held companies so that they can avoid the issues described in this letter and still prepare their financial statements in accordance with generally accepted accounting principles.

Very truly yours,

Thomas J. Crotty, Managing Partner