Letter of Comment No: 4768

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From: jaragona@austinventures.com

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To: Director - FASB

Cc: jcdowling@nvca.org; jdirvin@austinventures.com

Subject: Re: File 1102-100 Expensing of Employee Stock Options

June 15, 2004

Director Financial Accounting Standards Board

Re: File 1102-100

**Expensing of Employee Stock Options** 

I would like to offer comments regarding the proposed standard for expensing stock options – FASB Statement No. 123. My comments are general in nature and touch on several of the issues outlined in the exposure draft for comment.

I'm a general partner in a venture capital firm. Over the last 20 years, I have worked with numerous private technology and service companies across the United States. Over that same period of time, our firm has raised eight funds and has over \$2B under management. While I believe that the proposed standard for expensing stock options is a bad idea in general, I believe it is an extraordinarily bad idea for private companies for the reasons I have outlined below.

## Substantially reduced value of financial statements

As an investor in private companies, I believe that adding the expense associated with the fair value of stock options to the income statements and balance sheets of private companies makes my life harder, not easier. As I consider new investment opportunities in private companies, I pay attention to growth opportunity, cash flows over time and my ownership position. Stock options are an important consideration, but only in the context of fully diluted shares outstanding. Since stock option "expense" is a non-cash item, it has no relevance to my investment decision-making process. By including stock option expense in the financial statements, I now have to expend effort to extract it in order for the financial statements to be useful to me.

Given that private company stock price volatility is extraordinarily difficult to estimate (particularly for early stage private companies); the proposed standard will force private companies to use the intrinsic value method of estimating fair value. Since private company stock values can go down as well as up, private companies financial reports will be subject to swings in profitability – positive as well as negative – due to the expensing of stock options that will be very difficult to digest without peeling out that expense from the financial statements. This will make life even more difficult for investors and creditors alike.

In general, I think it would be very difficult to find an investor in private companies that believes expensing stock options adds value.

One alternative is for private companies to not comply with GAAP. Again, I think that is a bad idea. Investors and creditors need companies to comply with a reporting standard that they can count on to deliver consistent results over time.

## Increased administrative costs

The administrative effort and expense associated with the proposed standard compliance is meaningful. The proposed methods for stock option expensing will require significant effort and cost to perform and audit and will undoubtedly consume management time and my time ensuring the methodologies are applied correctly and the results are interpreted appropriately.

Here is an example of a typical company and the impact I believe the proposed standard will have on consumption of company resources. If we assume a company of 50 people with an average of 2 stock option grants each, with each of those grants subject to a 5 year vesting schedule with a one year cliff, that means that the company will need to make 4,900 (50 people\* 2 grants/person \* 49 vesting events/grant) separate expense calculations. Given that each grant has to be broken down into separate quarterly expense amounts over a one-to-five year vesting schedule, we are now up over tens of thousands of separate expense amounts. This is not even a big company.

The success of our portfolio companies, particularly private companies, is predicated on their ability to leverage a dollar spent into multiple dollars of return through the application of their time and talent. The administrative effort and costs of the proposed standard in terms of company dollars and time create no positive return, more likely, negative returns for the reasons outlined above. Let's not make the job any harder for our private companies.

# Reduced competitiveness

It is my belief that many of the companies in Asia that do now or will in the future compete with our portfolio companies in the US do not have to deal with the confusion and cost associated with expensing stock options. This gives those companies a decided advantage as our portfolio companies compete in an ever more global marketplace, especially when it comes to attracting capital and hiring the best people.

In summary, I think that the expensing of stock options for private companies is a terrible idea – it adds no value and lots of cost, as well as reduces the global competitiveness of our companies. I strongly urge you to exclude private companies from the stock option expensing requirement.

Thank you for your consideration.

Sincerely,

Joe Aragona General Partner Austin Ventures

Chairman-Elect National Venture Capital Association





Joe Aragona
General Partner
jaragona@austinventures.com
300 W.6th Street
Austin, TX 78701
Ph: 512.485.1901

Fax: 512.651.8501

http://www.austinventures.com

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