

ikon

Letter of Comment No: 4777
File Reference: 1102-100

From: Salim A L Bhatia [sbhatia@trinityconvergence.com]
Sent: Tuesday, June 22, 2004 5:44 PM
To: Director - FASB
Cc: jcdowling@nvca.org
Subject: Reference File No. 1102-100

Members of the FASB,

I am the Chief Executive Officer of Trinity Convergence, Inc., an emerging growth company located in Research Triangle Park, North Carolina. This is the third venture-backed company, with significant employee participation through stock options, which I have led. One of these I have taken public and another has been sold to a public company. I also sit on the Boards of two technology companies, one venture backed and another self financed. Both use stock options to give employees an opportunity to participate in the value they help create. Financial investors accept significant, but clear, dilution in ownership with the expectation that the participation by employees will eventually yield a better financial return to them. I also serve on the Board of the Council for Entrepreneurial Development.



I am very concerned about the impact of the FASB exposure draft, relating to the expensing of stock options, on private companies such as the ones I have led and built. Here I am speaking of companies where there are financial investors and stock options are granted to management, employees and certain contractors. I believe that stock options at start-up and emerging growth companies are a proven driver to innovation and value creation on an individual, company and country level. Stock options are significant component to our competitive advantage and the FASB rules have the potential to put this at risk. Specifically I believe the FASB rules will force companies such as mine to reconsider the broad-based granting of stock options because:

1. **Stock option expensing adds costs and consumes scarce cash** - There is no way that a young private company will have the expertise in-house to project the expense as provided for in the exposure draft. Experts will need to be retained and at a cost that will double or triple a companies cash spending on external accounting. Companies such as mine will not choose to spend their scarce dollars on stock option expense reporting when they are struggling to allocate spending between innovation and commercialization.
2. **Stock option expensing adds complexity and confusion to financial reporting** - In an attempt to apply a cost of stock options to the operating statement of a company one has to resort to complex techniques which require subjective input (Example: volatility in the stock of a company that has no public market) to arrive at some theoretical expense of stock options. Every month suppliers, customers and partners ask us for our financial statements to assess our staying power. With stock option expense reporting financial statements will become complex to decipher and because of the subjectivity will require a great deal more interaction and investment of time. As it is, emerging companies by their immaturity have to struggle to prove their credibility versus established companies. Companies such as mine cannot afford new hurdles to establishing vital relationships with suppliers, customers and partners.
3. **Stock option expensing will add uncertainty** - There is plenty of risk and uncertainty implicit in a new venture. Not knowing what will end up on the expense line and therefore how it will impact profitability on the income statement is a risk companies such as mine do not need. The realization that what one normally does to maximize profitability will actually raise the stock option expense and therefore lower reported profits is infuriating.
4. **We already have a way to show the cost impact of stock options** - Financial investors in a company granting stock options, under today's rules, know immediately that they are giving up a significant piece of their return. They know this quite definitively since their share of the value of the company is measured through their "fully diluted" ownership in the Company. Every time stock options are granted, the investors fully diluted ownership declines conveying clearly the financial impact of the stock option grant. Current accounting practice requires the clear reporting of the total fully diluted shares outstanding as well as the earnings per fully diluted share (which is lower than the earning per total outstanding shares because of stock options). There is no need to double count the financial impact of stock options and there certainly is no need to add the burden of a costly, confusingly complex and subjective expense component to the financial reporting of young companies.

I urge you to reconsider the exposure draft. In my 15 years building emerging growth companies I have experienced the value to companies and their financial owners of granting stock options. It will be a tragedy if the new rules undermine the competitive advantage America enjoys through its vibrant entrepreneurial community and its practice of spreading wealth through the granting of stock options to innovating entrepreneurs.

Sincerely,

NC

6/23/2004