



**Association for  
Financial Professionals**

Letter of Comment No: 4408  
File Reference: 1102-100

June 28, 2004

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

Re: File Reference No. 1102-100 Invitation to Comment, ED *Proposed Statement of Financial Accounting Standards Share-Based Payment an amendment of FASB Statements No. 123 and 95.*

The Association for Financial Professionals (AFP) representing approximately 14,000 financial and treasury executives nationwide welcomes the opportunity to respond to the Invitation to Comment (ITC) on accounting for stock options. AFP continues to oppose the requirement that companies record as an expense the fair value of stock options issued to employees. Employee stock options have value to employees and are a cost borne by shareholders, not the company. The cost of stock options is reflected in fully diluted earnings-per-share, under current accounting rules.

AFP is concerned that the proposed FAS 123 revision without a proper accounting between compensation attributes and equity ownership attributes of stock options will distort the financial presentation and discourage future use of stock options as an incentive to align employees with shareholders. Further, it will dampen the active participation of small investors (employees who are only able to become investors through low risk company stock options) in the marketplace.

AFP has the following comments or concerns:

- When the employee receives this contingent ownership benefit he/she takes on certain attributes of a shareholder/investor and it has never been correct under accounting methodology to classify increased shareholder wealth on the income statement.
- While the net result on the equity statement and the balance sheet will not be effected, the components within the equity statement (paid-in capital and retained earnings) could be distorted. This distortion will make it appear (if the retained earnings account is negative due to stock options) that the company is not capable of making a profit or generating income to pay debt service, when in fact the shareholders are simply sharing future growth with employees of the company. The result is that innovative and growing companies are at a distinct disadvantage with the market and lenders. The reality is that this could result in higher costs for

short-term working capital and long-term growth financing due to the appearance of higher credit risk.

- Mandatory expensing of shareholder wealth will result in overstating compensation, distorting a true and fair presentation of the financial information. Employees already receive cash and other benefits as compensation for services rendered throughout the year. The receipt of stock options by the employee may have some value at the time of grant, but due to the risk it should only be of nominal value.
- Stock options by their definition and classification have a stronger nexus to the equity of the company than to the operations of the company. When stock options are issued the employee receives attributes as a shareholder/investor which now places the person in both an employee relationship and in a contingent ownership relationship with the company. Many companies issue stock options as an incentive for the employees to share equity participation with the shareholders of the company. The reason options are the preferred vehicle as opposed to other forms of equity sharing arrangements, such as restricted stock, is to protect the employee from downside risk.
- AFP is pleased that the FASB proposal allows flexibility in the valuation model. Preference to the binomial lattice method over the Black-Scholes, as currently proposed, but with language that allows for flexibility based on facts and circumstances is desirable. However, we are concerned that the volatility component of both valuation models (a higher volatility variable will result in a higher relative stock option value) is problematic for growing and less mature companies.
- Stock option information is already disclosed in the footnotes and is reflected in fully diluted earnings-per-share under current accounting rules. Until there is a fair and equitable way to bifurcate the portion that might be for services rendered from the portion that is company equity, the standard should be delayed.

In light of these concerns, AFP makes the following recommendations:

1. Consider redrafting the standard to acknowledge that issuance of stock options represents a benefit to the employee that straddles two company-based components. One component represents the ownership attributes received by the employee. The second element may represent some component of compensation. Any inclusion of equity-based compensation in the statement of income should be limited to the fair value of employee services.
2. Explore alternatives that would resolve the problem with financial presentation of the equity statement and the potential distortion that may result from the application of this proposed standard (allocation between paid-in capital and retained earnings).

3. Consider enhanced disclosure of the dilution effect of stock options in the equity statement as a response to shareholder concerns about excessive stock option flexibility by management or opaque reporting of stock options.
4. Maintain the existing intrinsic method of valuing stock options as an alternative for nonpublic and small businesses.
5. Delay FAS 123 until economic impact studies have been performed that assess the effects of implementing this standard.
6. Perform additional analysis regarding the potential skewing of higher compensation values for younger high growth companies due to high volatility values.

The membership of AFP includes approximately 14,000 financial executives employed by over 5,000 corporations and other organizations. Our members represent a broad spectrum of financial disciplines; their organizations are drawn generally from the Fortune 1000 and middle-market companies in a wide variety of industries, including manufacturing, retail, energy, financial services, and technology. AFP supports members throughout their careers with research, continuing education, career development, professional certifications, publications, representation to key legislators and regulators, and the development of industry standards.

If you have any questions, please contact John Rieger, AFP Director of Accounting and Reporting at 301-961-8844.

Sincerely,



Alvin C. Rodack, CCM  
Associate Treasurer  
The Ohio State University  
Chairman  
Government Relations Committee



James R. Haddad, CCM  
Vice President Corporate Finance  
Cadence Design Systems, Inc.  
Chairman  
Financial Accounting and Investor  
Relations (FAIR) Task Force