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Letter of Comment No: 2347  
File Reference: 1102-100

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Financial Accounting Standard Board  
401 Merritt  
Norwalk, CT 06856-5116

RE: Exposure Draft No. 1102-100 Share Based Payments

Dear Sirs:

I am currently employed in the industry, have analyzed your exposure draft in depth and disagree with your findings. I disagree with your conclusion that stock options are an expense, your proposed methods of valuing those options, and the notion that expensing options will add more clarity to financial statements.

Accounting literature defines an expense as gross decreases in assets or gross increases in liabilities recognized and measured in conformity with generally accepted accounting principles that result from those types of profit-directed activities of an enterprise that can change owners' equity. From that we can derive that an expense can only occur when an asset is depleted or a liability is incurred. When an Employee Stock Option (ESO) is exercised an asset, cash, and equity, paid in capital, are increased. There is no decrease in any asset or increased liability as per the definition of an expense. Also, an expense must be measurable. The proposed valuation methods call for the accountant to make wide ranging assumptions to value ESO's. It is common accounting practice to wait until something can be valued before recording it as a transaction. Financial Statements should provide a clear picture of what has occurred and not what might occur. Pricing the current value of a security based on forecasts and future events should be left to the analysts and the market in general, not accountants.

The current ESO valuation models allow for too much subjectivity. This could significantly impair the comparability of financial statements and open the door for errors in judgment or intentional misstatement. There is no way to validate any ESO pricing model decided upon for public and private companies. For tradable securities, the market determines the accuracy of any pricing model. Value is what someone is willing to pay for another's goods or services. Since ESO's are not transferable they have no market value. They have value for one individual if they are vested, in the money, and exercised before they expire. Therefore, companies, accountants, and investors cannot confirm the accuracy of any proposed option expense and ultimately the financial statements on which they base their investment decisions on. Furthermore, the option expense valuation models are inconsistent and would yield different values for an identical company based on whether it was public or private. The private company would have a smaller ESO expense under the popular models for an identical transaction. Stock price volatility is the primary variable in most of the models and would yield a larger call

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premium for the public company. Thus, an investor would demand a higher rate of return from the public company based on their financial statement results. This increases the borrowing costs for public vs. private companies.

Financial Statements should provide uniform and consistent information for investors making capital allocation decisions. Our markets depend on the consistency and accuracy of our financial data to function efficiently. The current accounting rules provide investors with all of the needed information needed to determine the dilutive impact of ESO's and what affect that has on their investment return. The proposed valuation methods for expensing options will force accountants to make estimates that should be left to the individual investor and analysts. Forcing companies to expense ESO's under the current model will not provide a greater deal of clarity and consistency. The new rules will make comparability more difficult and force investors to back out the ESO expense in order to properly value companies and make market comparisons.

In closing, I believe that the FASB came to the correct accounting treatment in FAS 123 and F128. I strongly disagree with the exposure draft and respectfully request that it be withdrawn.

Sincerely,

  
Michael Vallejo