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Letter of Comment No: 4027 File Reference: 1102-100

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From: Liz Werwie [Liz@novakbiddle.com]

Sent: Tuesday, June 15, 2004 1:22 PM

To: Director - FASB

Cc: jcdowling@nvca.org; Liz Werwie

Subject: Reference File No. 1102-100

To:

FASB

From:

E. Roger Novak, Found Partner, Novak Biddle Venture Partners

Date:

June 15, 2004

Subject:

Reference File No. 1102-100

To Whom It May Concern:

I am writing in response to your request for comments regarding the expensing of stock options, specifically reference file no. 1102-100. While there are many compelling arguments around the economic impact of options in creating what has become the most dynamic entrepreneurial environment in the world, that is not the purpose of this letter. Instead I want to comment on what I believe are truly major technical flaws in the proposed draft. First, let's begin with an examination of whether an option is really an expense. The answer is empirically no. It neither creates a liability nor any out of pocket expense. While some have argued it represents an opportunity cost, I believe no other "opportunity cost" are accounted for on financial statements.

Now let's examine some valuation issues where I believe the draft is equally deficient. While you specifically require option expenses to be based on fair value, neither Black-Scholes or the Binomial Model produces the desired results. While weakness with Black-Scholes has been acknowledged for considerable time, I believe the Binomial Model is equal flawed. However in this case it is the result of the fact that is requires significantly more estimates.

When I invest in start-up companies, there are so many unknowns that valuation is at best, imprecise and subject to many day-to-day changes: management, competition, technology, deal structure etc. Trying to capture these fluctuations in a formula by multiple estimations is ridiculous and bound to be imprecise.

Further, let me raise another point with which I am concerned. As a majority of our portfolio companies have monthly vesting, it is my understanding that you consider each vesting date to be a separate grant, which must be calculated and tracked separately. This will not only create an administrative nightmare but significantly raise the cost of doing business for a young company with limited resources. This is another example of regulatory overkill.

I could go on and on about other issues but it would only reinforce my belief that this proposed draft is seriously flawed with respect to young private companies, whether they are venture-backed or not. If you are determined to push this through, I would ask that you would reconsider and exempt smaller private companies where this is not only a cost/regulatory issue, but if enacted would produce severely imprecise data.

Sincerely,

E. Roger Novak Jr.

Founding Partner, Novak Biddle Venture Partners