

June 14, 2004

Letter of Comment No: 3769
File Reference: 1102-100

Via mail and email

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
Proposed Statement of Financial Accounting Standards, *Share-
Based Payment, an amendment of FASB Statements No. 123 and
95*

Wells Fargo & Company (Wells Fargo) is a diversified financial services company with over \$390 billion in assets providing banking, insurance, investments, mortgage and consumer finance services. We appreciate the opportunity to comment on the issues being considered by the Board in determining whether to revise U.S. accounting standards on share-based payments.

Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation, established a fair value based accounting method for recording the cost of stock options. SFAS No. 123 also permits companies to continue to apply the intrinsic value based accounting method, presented in Accounting Principles Bulletin (APB) Opinion No. 25, Accounting for Stock Issued to Employees. The Proposed Statement of Financial Accounting Standards, *Share-Based Payment, an amendment of FASB Statements No. 123 and 95*, would mandate the use of only a fair value based accounting method, without permitting the application of the alternative intrinsic value based accounting method for all public companies.

Wells Fargo does not believe that the grant of a stock option meets the definition of an expense. Paragraph 80 of FASB Statement of Concepts No. 6, Elements of Financial Statements, defines expenses as follows: “Expenses are outflows or other using up of assets or incurrences of liability (or a combination of both) from delivering or producing goods, rendering services, carrying out other activities that constitute the entity’s ongoing major or central operations.”

All expenses have one thing in common: they reduce a corporation's net worth. Stock options have no impact on net worth at the time they are authorized and usually increase net worth at the time of exercise. Because there are no outflows, using up of assets, incurrence of liabilities or decreases in net worth associated with stock options, we don't believe stock option grants meet the definition of an expense. Mandating the fair value method requires an earnings charge even though there is no cash outflow and, in fact, there is a cash inflow associated with the exercise of the option.

Wells Fargo believes the intrinsic value method is the preferable method of accounting for stock options and believes that the Accounting Principles Board appropriately concluded on the accounting guidance for stock options 31 years ago when it issued APB No. 25. The intrinsic value method measures the economic impact of a stock option grant on earnings per share in terms of potential dilution to existing stockholders. By giving the grantee a right to buy shares at a predetermined price, a stock option grant has the potential to transfer to the grantee some of the claims of existing stockholders to the Company's future earnings. In effect, the impact of a stock option grant to existing stockholders is the possibility that their slice of the corporate earnings pie will be smaller if the option is exercised. Under the intrinsic value method, an estimate of this possibility is reflected in the difference between basic earnings per share and diluted earnings per share, the latter calculated based on assumptions about the exercise of outstanding in-the-money stock options.

In addition to not believing that the grant of stock options meets the definition of an expense, we have significant concerns with the reliability of any model used to estimate the fair value of stock options. The proposed method to calculate the value of the option grant (e.g., the binomial model) utilizes faulty assumptions in the calculation of the fair value of the option grant (as further detailed below). In addition, the fair value method actually provides less information to evaluate the Company's earnings. Net income and earnings per share would be calculated and presented under a single method. There is no alternative footnote disclosure to present the impact of stock options "as if" the intrinsic value method had been used. By contrast, Statement of Financial Accounting Standards No. 148, Accounting for Stock-Based Compensation-Transition and Disclosure, not only permits, but requires, prominent quarterly disclosure of the fair value impact of stock options in the footnotes to the financial statements. Moreover, the footnote disclosure already provides information about the assumptions used to calculate fair value, such as the weighted average exercise price of outstanding stock options and the expected dividend yield, stock price volatility and option duration. As such, expensing a stock option grant in the income statement would not add any information not already collectively provided in the financial statements and notes to the financial statements.

We agree with the Board that the use of a binomial model is preferable to the use of a Black-Scholes model for estimating the fair value of employee stock options because the binomial model offers greater flexibility to reflect the unique characteristics of these instruments. Even this model, however, has flaws that prevent it from providing a meaningful estimate of fair value for employee stock options. Option pricing models calculate a fair value for stock options assuming the option holder has the ability to transfer options to an independent third party.

Employee stock options differ from other options in that they can only be exercised and not transferred, thus significantly reducing the true value of an employee stock option compared to the calculated value. Although the binomial model better accommodates the notion that employee options are not readily transferred, we are not aware of any valuation model which will precisely generate a value that is representative of an employee stock option's true fair value. Therefore, we do not believe that any option pricing model produces a sufficiently reliable measurement of fair value for use in the primary financial statements.

Employee stock options are widely used today because they are an indispensable part of any comprehensive compensation strategy. They are very effective in aligning interests of a company's employees with its shareholders and can help attract top talent. Proponents of expensing stock options argue that the failure to expense them could result in the excessive use of options. Potential abuses associated with excessive use of options are best addressed by holding directors accountable for compensation paid to corporate executives – not by the FASB mandating expensing of stock options. We believe that expensing them will discourage companies from using options, effectively eliminating the positive impacts that they produce.

Based on the foregoing, we do not support changes to FASB Statement 123 that would (1) eliminate an enterprise's ability to account for stock options under APB Opinion No. 25, and (2) mandate the use of option-pricing models that we believe to be unreliable in determining an option's fair value.

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We appreciate the opportunity to comment on the issues contained in the Board's invitation. If you have any questions, please contact me at (415) 222-3119.

Sincerely,

/s/ Richard D. Levy

Richard D. Levy
Senior Vice President & Controller

CC: Ms. Donna Fisher, American Bankers Association
Ms. Gail Haas, New York Clearinghouse Corporation