

To: FASB Directors  
cc: Jennifer Connell Dowling, NVCA

Letter of Comment No: 3267  
File Reference: 1102-100

Reference: File Reference No. 1102-100

**Comments of Kevin J Efrusy to the FASB Exposure Draft entitled *Share-Based Payment, and Amendment of FASB Statements No. 123 and 95.***

I have been active in the entrepreneurial and venture capital communities for the past 8 years. This includes time as a rank-and-file employee of a startup company, a startup CEO/founder, and now as a venture investor at Accel Partners. Accel Partners manages over \$3 billion in capital and has invested in more than 200 early stage companies in emerging markets during our 20-year history. In addition, I have also invested personal capital in both private and public technology companies that have used stock options as a compensation tool.

Few would challenge the entrepreneurial economy has been responsible for a disproportionate amount of job creation and productivity enhancements over the past several decades. However, such innovation requires an environment where an entire ecosystem has incentives to take very substantial risks—the entrepreneur, the early employees (who virtually without exception leave higher-paying more secure jobs elsewhere), and the early venture investors. The new accounting rules outlined in the Exposure Draft create disincentives to start ups that want to utilize employee stock options as a part of their business model. Eliminating or reducing the use of employee stock options would do a great deal of damage to the business model that has been so successful in the past.

The disincentives arise from the near impossibility to accurately assign option value to equity in such an illiquid, high-risk security. No matter what formulation might be used (whether it is Black-Scholes or binomial valuation methodology), the nature and degree of risk in so many private companies is guaranteed to render any calculation so inaccurate that assigning a specific value actually is more misleading than simply disclosing the company's detailed capital structure and allowing investors to anticipate the dilutive impact of options under different scenarios of their choosing. For example, being "conservative" from a profit-and-loss standpoint would argue towards assigning a relatively high value to stock options, but current and prospective employees (as well as prospective investors) might perceive such a stance as aggressive and misleading—especially if the company ends up performing poorly. The potential damage to reputations of executives and investors from such inaccurate attempts at valuation would discourage the use of stock options and thus of much entrepreneurial risk-taking in general.

I am not arguing that stock options do not represent real costs to companies. Stock options granted to employees obviously could instead be held by the corporation and eventually sold for cash when and if the corporation's securities become liquid. This cost is an opportunity cost however, not a direct or indirect compensation expense. As

such, it is inappropriate to account for these transactions as compensation expenses. One also should recognize that the true quantification of the value of stock options—even within an order of magnitude—does not become clear for a number of years, and thus the presence of an in-period expense in private company financial truly causes more obfuscation than clarity.

While FASB has admirably sought to address this issue with the “intrinsic value” method when it is not possible to estimate fair value, this methodology does not solve the problem. Using the intrinsic value method a company would need to re-estimate its fair value each reporting period. The information and uncertainty about an early company’s prospects and value differ markedly from quarter to quarter—resulting in inconsistencies that are very difficult to explain and only add to the confusion of employees and investors alike.

Not only might the regulations impact entrepreneurial risk-taking within the economy, but also they would impose substantial new cash expenses upon fledgling companies that choose to go forward. These expenses would take the form of professional service fees required to perform the appropriate valuation work and adjustments to financial reports. These costs are an area of particular concern to private start up companies who are in less of a position to absorb costs and whose shares are very difficult to value using the proposed valuation methods.

If FASB ultimately decides to implement some form of the proposed option expense regulations, then at a minimum it should consider providing an exemption from the new rules to private companies and to any broad based employee option pool.

Sincerely,

Kevin J. Efrusy  
Accel Partners