

Reference Number 1102-100

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Letter of Comment No: 2269

File Reference: 1102-100

From: Bill Krepick [bkrepick@macrovision.com]

Sent: Thursday, May 06, 2004 9:35 PM

To: Director - FASB

Subject: Reference Number 1102-100

Via e-mail: director@fasb.org

Reference Number 1102-100

To: Director of Major Projects:

The attached letter is in reference to the Exposure Draft, Proposed Statement of Financial Accounting Standards, Share-Based Payment, an amendment of FASB Statements No. 123 and 95, released on March 31, 2004. We are writing on behalf of Macrovision Corporation, a Delaware Company, based in Santa Clara, California. Macrovision is a company with 360 employees worldwide, in the business of rights management technology and intellectual property. Our success is fundamentally based on our human capital. We appreciate the opportunity for comment, and would like to go on record as being against FASB's proposal to expense stock options as currently recommended. Macrovision believes a poorly-designed stock option expensing regimen will have adverse consequences which will affect the economy, employee morale and shareholders. We believe expensing stock options without a clear, consistent and meaningful valuation methodology is counterproductive. It will create more confusion than transparency in financial reporting. Please see the attached WORD file for our detailed position.

Sincerely,

John Ryan

Chairman

Bill Krepick

President/CEO

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cc: Hard copy by mail to:

Financial Accounting Standards Board

401 Merritt 7

P.O. Box 5116

5/7/2004

May 7, 2004

Via e-mail: director@fasb.org

File Ref No. 1102 – 100

Hard copy by mail to:

Financial Accounting Standards Board
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To: Director of Major Projects:

Introduction

This letter is in reference to the Exposure Draft, Proposed Statement of Financial Accounting Standards, Share-Based Payment, an amendment of FASB Statements No. 123 and 95, released on March 31, 2004. We are writing on behalf of Macrovision Corporation, a Delaware Company, based in Santa Clara, California. Macrovision is a Company with 360 employees worldwide, in the business of rights management technology and intellectual property. Our success is fundamentally based on our human capital. We appreciate the opportunity for comment, and would like to go on record as being against FASB's proposal to expense stock options as currently recommended. Macrovision believes a poorly-designed stock option expensing regimen will have adverse consequences which will affect the economy, employee morale and shareholders. We believe expensing stock options without a clear, consistent and meaningful valuation methodology is counterproductive. It will create more confusion than transparency in financial reporting.

Economic considerations

Macrovision offers options to 100% of its employees, along with an employee stock purchase plan, as the key elements of its equity compensation plan to recruit, reward and retain employees. We strongly believe that broad based employee equity ownership is one of the main factors contributing to the excellent revenue and earnings growth Macrovision has had since its inception. Stock options and ESPP have been significant motivational tools and the impetus for people taking entrepreneurial risk that has spurred technology innovation. This is not only true at Macrovision, but throughout the entire Silicon Valley. If stock option expensing becomes mandatory, many companies will be forced to greatly reduce or eliminate their broad based stock option plans. This could reduce the incentive for people to take entrepreneurial risk, with negative implications for the US economy.

Accounting considerations

APB 25 is the current accounting method used by most companies when accounting for stock options. Macrovision believes that APB 25 already provides adequate guidance regarding stock options and how they should be expensed in certain situations. If an option is granted “in-the-money”, meaning it has intrinsic value (because the option price is less than the fair market value), APB 25 requires the intrinsic value to be expensed over the vesting period of the grant. With intrinsic value there is a quantifiable value based on the difference between the stock option’s exercise price and the fair market value of the stock. Most stock options are granted at fair market value, which means they have zero intrinsic value. APB 25, in turn, defines that as zero compensation, so the company does not recognize any expense. The time of grant is the critical date (“measurement date”) for determining the compensatory value of any stock option. APB 25 recognizes it is irrelevant as to whether or not that stock appreciates or depreciates over time, assuming the option is a fixed grant (meaning its exercise price and number of shares are determinable at the grant date). In our opinion, APB 25 provides a fair approach to accounting for stock options and, significantly, is consistent with the IRS’ treatment and rules regarding compensation for employees.

The IRS is the governing body that determines what constitutes compensation. It seems reasonable that Accounting Standards, as promulgated by the FASB, should be consistent with this. If, at the time of grant, an employee does not have to treat the grant as W-2 income, it makes no sense for the company to have to report stock compensation expense on their income statement. This is tantamount to the IRS implementing a rule that people have to approximate their capital gains at the time they buy stock and report it on Schedule D, and then pay taxes on it as opposed to waiting until the stock is sold to determine the actual gains.

The argument might be put forth that stock options should be recognized as an expense at the time of exercise since the IRS recognizes that as income to the employee. While it is true there is income to the employee at the time of exercise, the company is not providing cash to the employee. The compensation resulting from the exercise is the individual’s short-term capital gain, and is not part of compensation.

Stock options are already factored into the diluted EPS calculation that companies publish and file with the SEC. Dilutive stock options increase the denominator in the EPS calculation, thereby reducing earnings per share; in other words, there is already a negative, accounting impact of issuing valuable options in the income statement. Dilutive stock options include any stock option that is at or below the average market value during the given time period being measured. The dilutive stock options may not yet even be vested or ever actually be exercised due to termination or subsequently becoming “out-of-the-money.” Adding an estimated, non-cash expense on the income statement would reduce earnings in a manner that does not reflect the underlying economic performance of the company – its ability to generate cash.

Valuation considerations

Valuation of stock options is complex and problematic. FASB takes the approach that the potential for appreciation of a stock option has some measurable value or worth. It does not matter if that appreciation is actually ever realized. The variables that are currently used under FAS123, either Black-Scholes or the Binomial Method, are complex valuation tools for which the input assumptions can be manipulated to drive a broad range of outcomes. While they may be useful tools for valuing an option to a prospective investor, they grossly exaggerate the actual cost to the company. The input variables are all based on past performance, which may not be an

indicator of the future. The valuation models used always assume that the options will have value, which may not be the case.

Financial reporting considerations

Stock-based compensation expense is currently reported in SEC filings in footnotes to the financial statements. Once an option is valued at the time of grant, that expense is amortized over the vesting period regardless of its chances of ever being exercised. The Black-Scholes valuation methodology does not re-value an option when it becomes out of the money. However, out of the money options are not included in the EPS calculation. Rather than helping a shareholder understand the real costs associated with running a business, expensing stock options requires further interpretation and analysis by shareholders. They will have to try to understand why a company is generating positive cash flow yet reporting a net loss. Accounting should produce consistent and reliable financial statements; expensing stock options with the valuation methods being proposed will not provide such consistency and reliability.

Macrovision completely supports any approach which makes financial reporting more transparent for shareholders and ensures the integrity of earnings. However, as stated earlier, expensing stock options would do the exact opposite and would make it much more difficult for shareholders to understand a corporation's economic performance. Under FASB's proposed stock option expensing guidelines, companies will utilize different methodologies to value option grants, making comparisons between companies extremely difficult. It will drive companies to continue use of "pro forma" presentation of financial results, where each company has a different approach to calculating "pro forma" earnings.

Macrovision has been, and remains, a very profitable company. However, the footnotes in our latest 10-K indicate that, if expensing stock options had been mandatory as proposed, Macrovision would have shown a net loss in 2 of the last 3 years. Yet, if a shareholder examined the statement of cash flows they would realize Macrovision was in fact generating substantial amounts of cash – in other words, economically profitable. Stock option expensing would cause the income statement to become a misleading measure of a company's results of operations. Financially sophisticated investors will be able to determine the economic performance of the company, so they will have a considerable advantage over the average investor who believes that GAAP earnings are all that matters.

Corporate Governance

In perusing many of the letters sent in to the FASB regarding the Exposure Draft, many of those who advocate expensing stock options seem to do so for the wrong reasons. They tend to focus on executive greed. Unfortunately, stock option expensing gathered new momentum and favor due to events at a few companies such as Enron, Worldcom and Global Crossing. Stock options in themselves do not make people corrupt. Stock options became a lightning rod for shareholder discontent. The Sarbanes-Oxley legislation was implemented to strengthen Corporate Governance. Expensing stock options will not improve Corporate Governance. Selecting the right leaders, with appropriate Board and Audit Committee checks and balances, is a far more effective way to control corporate greed.

Studies show a positive correlation between employee ownership within a company and company performance measured by total shareholder returns over a period of time. The more employees who participate in equity ownership, the better the returns are for the shareholders. By expensing stock options, companies may be forced to eliminate some of their broad-based equity ownership programs, which will hurt overall shareholder returns in the long run. This will also lower

employee morale, as employees will no longer feel tied to the company or benefit from its success. Executives will still continue to receive stock option grants, but rank and file employees will not. Most of the companies that have voluntarily started expensing stock options have done so because they were primarily executive-based plans, and the potential expense had virtually no earnings impact. In most of the letters supporting stock option expensing, small investors were lauding FASB's decision because they felt it would eliminate excessive grants to executives; in reality, stock option expensing will likely eliminate small grants to rank and file employees while executives still remain highly compensated.

Conclusion

Stock options are about aligning the interests all employees with those of the shareholders. Stock options are a way for employees, who work diligently for the shareholders, to be rewarded for the risks they undertake and the long hours they work. At Macrovision, there are many employees who, because of stock options, were able to either buy a home or provide a better life for their families. Shareholders need to remember that investment returns largely hinge on the determination and motivation of the employees to achieve financial and operating goals.

Macrovision strongly encourages FASB to re-examine their proposal to make stock option expensing mandatory. We recommend that FASB leave stock option accounting rules as they were prior to the Exposure Draft. From an accounting, financial transparency and broader economic perspective, stock option expensing simply does not make sense. If FASB insists on mandating stock option expensing, we believe it is vital that a single, mandated valuation technique is included as a key element of the directive. We also believe that this valuation technique should reflect current quantitative analysis developed on Wall Street which indicates options should be valued at deep discount to the Black-Scholes model, given that stock options are not freely-tradable, may expire worthless or may never be sold. Any other approach would result in financial statements that are misleading to the average investor, proliferation of "pro forma" presentation of financial results and the exclusion of a significant part of the employee base from receiving option grants.

Sincerely,

John Ryan
Chairman

William Krepick
President/CEO

Ian Halifax
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