

ikon

From: Newell, Cheryl [cnewell@ev3.net]
Sent: Friday, May 21, 2004 11:17 AM
To: Director - FASB
Subject: Proposed Amendments to FAS 123

Letter of Comment No: 2675
File Reference: 1102-100



FASB Letter May 21 InterScan_SafeSta
2004.doc (5... mp.txt (360 B...

<<FASB Letter May 21 2004.doc>>

Dear Sir or Madam,

In response to the Financial Accounting Standards Board's Invitation to Comment on accounting for employee stock options, I am writing to you as the Chief Financial Officer of ev3, Inc., an emerging growth company, to express strong opposition to the proposal as currently drafted. I believe the proposed amendments to FAS 123, if enacted, would (1) be detrimental to emerging growth companies and the economy; (2) substantially increase the subjectivity, complexity and cost of financial reporting; and (3) penalize rank-and-file workers currently receiving stock options. The attached letter further explains my position.

Cheryl Nowell
Vice President and Chief Financial Officer
ev3 Inc
4600 Nathan Lane N
Plymouth, MN 55442
763-398-7538 (phone)
cnewell@ev3.net

This message has been checked for all known viruses



AN ENDOVASCULAR COMPANY

4600 Nathan Lane N.
Plymouth, MN 55442
PH 763-398-7000
FX 763-398-7200

May 21, 2004

*Via e-mail:
director@fasb.org*

Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

re: Proposed Amendments to FAS 123

Dear Sir or Madam:

In response to the Financial Accounting Standards Board's Invitation to Comment on accounting for employee stock options, I am writing to you as the Chief Financial Officer of ev3, Inc., an emerging growth company, to express strong opposition to the proposal as currently drafted. I believe the proposed amendments to FAS 123, if enacted, would (1) be detrimental to emerging growth companies and the economy; (2) substantially increase the subjectivity, complexity and cost of financial reporting; and (3) penalize rank-and-file workers currently receiving stock options.

ev3, Inc., is a privately held medical device company, focused solely on developing compelling products for endovascular treatment, primarily through minimally invasive catheter-based approaches. The Company is driving business around the world and is working closely with global endovascular thought leaders. Revenues are growing rapidly and are expected to exceed \$100 million in 2004.

If the proposed amendments to FAS 123 were enacted, I believe the following would occur:

- Emerging growth companies and the economy would suffer.

Emerging growth companies are a vital innovation engine for the industry in which they participate and the economy in general. Large, public companies tend to be significantly more risk averse than start-up companies and often utilize a strategy of allowing smaller companies to "prove out" a technological innovation before applying R&D investment themselves or acquiring the smaller company.

Virtually all emerging growth companies rely heavily on stock options to leverage tight payroll budgets and compete for top talent with larger, more established companies. Stock options are a key component of compensation and critical to ev3's ability to entice top talent to join, and remain, with the Company.

In light of the new standard, if ev3 chooses to limit its use of stock options to protect its income statement, we would be placed at a significant recruiting disadvantage relative to mature companies. If, on the other hand, we choose to continue issuing options, our financial statements would be much more severely impacted by the resultant compensation expense than larger companies, putting us at a disadvantage when trying to raise capital. Either choice would result in our company being severely disadvantaged versus established companies and potentially crippling our ability to grow.

- The subjectivity, complexity and cost of financial reporting would increase substantially.

FAS 5, issued in 1975, is a basic tenet of financial accounting. While not directly applicable to this situation, the basic concept of FAS 5 is a pervasive theme in financial accounting. As you are well aware, two requirements must be met before a loss or expense can be recorded: (a) It must be probable that a liability has been incurred, and (b) one must be able to reasonably estimate the amount of the loss or expense. No such reasonable estimate can be made for stock options.

The two methods recommended by the FASB for valuing options, the Black Scholes and the Binomial Method, are both highly subjective, prone to error or outright manipulation and devilishly complicated to implement. While challenging for public entities, determining this valuation for an emerging growth company is virtually impossible. In most cases there are no benchmarks, no underlying stock performance history, and no budget to hire financial experts to develop models to obtain supposedly accurate valuations.

The FASB has offered the intrinsic valuation model for private companies, but this is really another name for variable accounting. If a private company using the intrinsic valuation model goes public, its stock compensation expense will fluctuate wildly each quarter depending on its stock price.

Expensing stock options in emerging growth companies is very misleading to investors, bankers, and employees. For example, key assumptions must be made using Black Scholes or the Binomial method, including the average maturity of the options (impossible to know with an emerging growth company, because there is not history), and volatility of the stock relative to the market (also

impossible to know because there is no history.) Depending on the assumptions, the value of the option varies greatly. Under the proposal, options would be expensed as issued, using at best, guesses as to average maturity and volatility. Accounting is supposed to be based on facts, not guesses.

If the price of the stock falls below the exercise price, the options are “under water”. The employee has received no benefit, and the Company has expensed compensation expense that did not exist, thereby overstating its operating expenses. To further confuse matters, most bank covenants are based on operating performance or leverage. Both measures would be overstated, and thus negative for the Company, if options are expensed. If the Company’s stock is highly volatile, which is frequently the case for emerging growth companies, the Company would have to expense stock options to compensation expense some quarters if the stock price rises, and not other quarters if the stock price falls. The variability to operating earnings are horrific. Anyone who relies on the Company’s financial statements, including, investors, bankers, vendors, and employees, are confused, not enlightened.

Under the proposed amendments, ev3’s operating loss would be increased more than 10% if options are expensed. This is a huge increase when the Company is striving toward profitability. Every dollar of operating expense saved by not expensing options makes it easier to the Company to raise capital through its banks, improve terms with its vendors, attract and retain employees, and ensure its long term success.

The fact that valuing stock options has been debated for years and that the two recommended methods are both fraught with ambiguity and complexity are clear indications that a reasonable estimate is simply not possible in this area. Ultimately, forcing companies to adopt these approaches will result in a much higher level of subjectivity and lower level of comparability in financial reporting at a time when investors are demanding just the opposite. This combined with the complexity and cost of implementing as well as the certain confusion this will cause to users of our financial statements makes this proposal impossible for us to support.

- Rank-and-file employees would be penalized.

It has become increasingly common over the last 10 years for employers to offer stock options to all levels of employees. It is widely accepted that employee-shareholders are more productive and innovative than employees working only for cash compensation. The widespread use of stock options has undoubtedly contributed to the significant productivity increases the U.S. economy has enjoyed in the last decade.

May 21, 2004
Page 4

The FASB's proposal is likely to have the unintended effect of eliminating stock options for lower level employees in favor of key executives. In an effort to contain the damage to their income statements, companies are likely to ration their stock options, saving them for those key positions where they are needed for competitive recruitment. This will most likely lead to less innovation, less productivity enhancements, slower growth and less employment.

I understand and appreciate the desire to reform corporate accounting in the wake of the recent scandals, but penalizing emerging growth companies that are the lifeblood of the economy is not the solution. In fact, as described above, I firmly believe the new standard, if enacted, would be a significant step backwards in terms of fair, objective financial reporting. I urge the FASB to reconsider its position and withdraw the proposed changes to FAS 123.

Sincerely,

Cheryl W. Newell
Vice President and Chief Financial Officer