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Letter of Comment No: 5289
File Reference: 1102-100

From: Bailye, John [John.Bailye@dendrite.com]

Sent: Thursday, June 24, 2004 6:45 PM

To: Director - FASB

DENDRITE

June 24, 2004

Ms. Suzanne Bielstein
Director of Major Projects and Technical Activities
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116

Re: Accounting for Stock-Based Compensation
Reference No. 1102-100

Dear Ms. Bielstein:

Dendrite is a New Jersey based corporation that develops and delivers solutions that increase the productivity of sales, marketing, and clinical processes for pharmaceutical and other life science clients. We would like to share with you our comments on the new *Accounting for Stock-Based Compensation* Exposure Draft.

As a growing, public company, we will face exceptional challenges with the proposed accounting rules for stock-based compensation. We respectfully disagree with the ruling that requires the expensing of all employee stock options (ESOs) as there is no reliable measure for companies to accurately value these ESOs for financial reporting. Mandating expensing under the proposed model will substantially and inaccurately over-inflate the value of the ESOs, resulting in financial statements that do not properly portray the company's true operational profitability to shareholders or employees. As a result, we are reconsidering our plans to issue new stock options to employees, which, under this new plan, will likely mean the discontinuation of stock option grants due to the significant burden this will place on our perceived financial health. A change such as this will clearly have a significant de-motivating effect on our employees where stock options are granted as a means of encouraging ownership in our company as well as incentive to help grow the business. We expect to see this effect reflected ultimately in shareholder value. In addition, we would like to submit the following commentary for consideration on the Exposure Draft:

Double Impact - Expensing ESOs have a doubly dilutive impact on the shareholders. By expensing stock options on the Income Statement, companies will first reduce net income and second, earnings per share will be negatively impacted by inclusion of the same options in the fully diluted shares in the denominator of the EPS calculation. In addition to the double impact, it is our position that the excess tax benefit associated with this activity should continue to be reflected in cash flow from operations instead of the new proposal to reflect this as a cash flow from financing activities.

Ability to Recover - The expensing of ESOs presents an imbalance in a company's obligation to recognize expenses, which significantly affects the EPS of the stock and consequently the value to the shareholder. Public companies will be forced to take an up-front operational expense for an assumed, unqualified value of a stock option grant. However, the ruling allows no recovery provision in the event that an option expires worthless. Situations where companies will not be able to record a recovery and no economic benefit has accrued to the employee include:

- Stock price never rises above its exercise price.
- Employees terminate before vesting or while options are "out of the money".

The ruling appears unbalanced and misleading if the employee only recognizes personal income at the time of actual exercise, but the company must recognize an expense at the time of grant based on a speculative future value.

Financial Reporting Reliability - It is unclear if we should use a binomial based or Black-Scholes pricing model of discounted cash flow values of future events to be used in adjusting today's transactions. It is our position that options should not be expensed, because there is no cash layout on the part of the company. In fact, the only cash that changes hands is from the employee to the company upon exercise at a future date. Moreover, ESOs do not have a similar value to options

traded on the open market as they cannot be sold by the employees. They represent an option for the future, a future that cannot be reliably predicted. As with any publicly traded company, prices of our stock will change over time and employees may even leave the employ of the company before exercising their options. The proposed option models appear to allow a significant amount of subjectivity when determining the compensation expense. Further, a minor variation in the valuation inputs results in a significantly different financial result. In fact, as I write this letter, many consulting companies are seeking to exploit this proposed accounting change by selling lucrative project work to companies where they will offer custom valuation models designed to minimize the valuation of future ESOs that may be granted. The proposed rules will reduce the comparability of financial statements, as each reporting company uses its own uniquely developed valuation model. Moreover, it is our position that users of financial statements will focus on a company's financial results excluding the impact of stock option expensing, placing more reliance on "Non-GAAP" reporting measures, further impairing the comparability of results within a peer group. Mandatory expensing of ESOs will likely confuse and mislead our shareholders and investors as we try to describe the reason for changes in the expense resulting from the use of complex option-pricing models.

In summary, the proposed change in accounting will adversely impact innovation, economic growth and competitiveness. Without the reasonable ability to offer this type of incentive, we lose a significant motivational tool used to encourage those who provide "great ideas" to help the business flourish and to recognize hard work.

Sincerely,

/s/ John Bailye
 Chairman & CEO
 Dendrite International, Inc.

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