

June 21, 2004

Letter of Comment No: 5277
File Reference: 1102-100

To: Director, FASB
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This letter is submitted pursuant to the request for public comments relating to stock option expensing, on behalf of Connetics, a small market capitalization public pharmaceutical company. We are opposed to the recommendation to expense stock options and strongly encourage FASB to delay the implementation of any requirement for public companies to expense stock options until all of the mechanics of such a requirement are understood.

The change in expense accounting as proposed will result in arbitrary and incomparable accounting for companies, and it will have a negative impact on the ability of U.S. growth companies to recruit leaders and employees. Ultimately, this effort will neither create more financial clarity for investors nor prevent abusive compensation practices.

The Concept and Method of Expensing Stock Options is Flawed

Double Counting: Options already have costs associated with them: they are counted as a part of diluted shares outstanding and inherently have a direct accounting and financial cost that is already captured in financial reporting. As a profitable operating company, our outstanding share base is increased by about 10 percent with the addition of fully diluted options, which in turn has the effect of diluting our reported earnings per share when we issue stock for compensation. The "expense" of issuing stock options will be double counted if there is a requirement to expense stock options in addition to recognizing them as outstanding shares. Ultimately, shareholders should decide how much equity they are willing to allocate to management and employees to run their business.

Valuation Methods are Arbitrary and Inappropriate.

The Ultimate Conundrum: With stock option expensing, one-size does not fit all, and multiple valuations options for companies to choose among will create confusion and accounting incomparability. The size, growth prospects, and risk profile of a company have profound impacts on the potential value of that company's stock. There is no valuation model that uniformly applies to all companies. Moreover, one model will not be relevant to the same company as it advances through its lifecycle. Permitting companies to populate their valuation models with their own variables is arbitrary and will create incomparability between companies, which in turn will make it more difficult for investors to make informed evaluations and decisions.

Valuation Date: There is no accurate way to value an option on the day it is granted. It is true that stock options are a form of compensation, but the compensation occurs when the options are exercised, not when they are granted. Underwater stock options never become compensation and the options are worthless. In fact, up until the date of exercise, stock options are not compensation, and until the exercise date we do not know how much compensation has been received. Any time before that, we would just be guessing how much the market would value the options on the day before they are counted.

Expensing options will unequivocally create confusion with investors and will generate additional hard costs as companies employ consultants and third party auditors to help justify their valuation assumptions.

Accounting Change Will Have a Profound Negative Impact on Business

Micro, small and mid-cap growth companies effectively and appropriately utilize equity compensation as a means to recruit and retain management. These companies are often risky, if not speculative places to work, and they do not have the cash to compete with larger companies to incentivize senior management to work for them. Equity compensation is used to provide the management the incentive to stay and perform on the job, instead of going to a more steady cash-rich company. Options do have value as they are the conveyance of equity or ownership to employees which dilutes the earnings shared by all stockholders. Companies who use options should not be penalized for having to expense them as well.

FASB Rule Does Not Eliminate Management Discretion.

One theory behind requiring expensing of options is that executives who managed the infamous companies (Enron, Tyco et al.) had a powerful incentive to “cheat” so that they could run up the value of their stock and then cash out their stock options. The FASB Rule – which does not offer any definitive guidance on the expensing model to use – leaves the expensing entirely up to the discretion of management. In other words, the one problem it does not solve is the problem that gave life to the idea.

For these reasons, we do not think options should be expensed. They are already captured in the income statement for public reporting companies and the existing disclosure requirements relating to options are sufficient. Any move to force option expensing on companies will create confusion with investors and analysts and the requirement will not curb the abusive compensations practices that have been headlined.

At the very least, we implore FASB to consider a delay to the implementation of stock option expensing. Companies, auditors, FASB, the SEC and market exchanges need more time to deliberate over the appropriateness of option expensing and the method to do so. This is a potentially catastrophic change to financial accounting that should not be rushed without thorough vetting.

Sincerely,

John L. Higgins
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