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Letter of Comment No: 5853  
File Reference: 1102-100

**From:** Matt Pfeffer [Matt.Pfeffer@cellgenesys.com]

**Sent:** Wednesday, June 30, 2004 4:29 PM

**To:** Director - FASB

**Subject:** File Reference No. 1102-100

June 29, 2004

To: The Financial Accounting Standards Board

Re: File Reference No. 1102-100

As a certified public accountant with over 20 years of experience in the field, as the chief financial officer of a public biotechnology company, and as a concerned United States citizen, I am writing today to express my serious concerns over your proposed new regulations requiring the expensing of employee stock options. I say I am writing as each of these three things for a considered reason. Namely, from my viewpoint as each, I have a different set of reasons to be opposed to this measure. These reasons are all different, but none is contradictory and all support the view that the proposed rules in regards to employee stock options be reconsidered.

First, writing as a long-time CPA, I must take exception with some of the fundamental concepts underlying the suggestion that employee stock options should be expensed. While I find it difficult to argue with Warren Buffet when he says that employee stock options obviously have value or nobody would want them, I will argue with his conclusion that this necessarily means that the grant should be treated as an expense to the company. The grant of a stock option to an employee costs the company nothing. There is no loss of any economic value to the company and no outflow of any cash or other asset. Rather, it is a cost to the shareholders of the company directly, in the form of potential dilution of their ownership. And this dilution or potential dilution is already included in the financial statements under existing accounting rules. To include some "artificial" cost of stock options as an expense, thus including the effect in both the numerator and the denominator of an EPS calculation, would be a double counting of this effect.

In the previous paragraph I alluded to the artificial cost of the stock option because I believe existing proposals are just that. Every credible expert in the field agrees that existing option valuation schemes, including not only the Black Scholes method but also the binomial or matrix valuation models, was not designed for and does not accurately measure the value of employee granted stock options. None of these measures accurately take into account the differences in these options compared to traded options that greatly influence their value such as lack of transferability, inability to hedge, vesting periods, and sales restrictions, including black-out periods, to name a few. As a consequence, even if you wrongly believed that these options should be expensed, you are left with the problem of how to accurately do so. It is troubling to me that we would consider valuation methods acknowledged to be flawed and open to interpretation in assumptions that can cause wild swings in value in constructing financial statements. Such a path will only lead to more investor confusion and skepticism over the validity and value of financial statements than we have today. I don't believe the accounting profession should be in this position. Bottom line, the proposed rules are simply bad accounting.

As the CFO of a public biotechnology company, I have grave concerns about the effect of this rule change on our ability to offer options to the rank and file members of the company and the effect it might have on our ability to attract and retain qualified personnel to this industry. Biotechnology, by its nature, is highly speculative and carries a great deal of risk. Innovative, first of kind treatments such as our cancer vaccines, for example, carry with them a very high risk that they will never be approved for market. At the same time, the path to development is a long and costly one, and the greatest risk and most common outcome for a biotechnology company is that it will run out of cash before it successfully markets a product. Some very promising technologies that might have helped countless people have fallen by the wayside as a result. Since cash is, to a company like ours, both precious and scarce, the ability to use options to attract personnel, to essentially have them throw in their lot with the shareholders and bet on the potential success of

7/1/2004

the company, is critical to our potential future success. Were it not for the ability of this industry to utilize stock options as we have in the past, many, if not most, of the newest and most innovative treatments for disease would not be on the market helping the people they are today.

Taking a broader view as a citizen of the United States, I am concerned about what these proposed rules will do to our economy and ability to compete internationally. Broad-based stock option plans have significantly increased company productivity, spurred capital formation, and fueled growth of some of the nation's most innovative companies. This is something that has not gone unnoticed by foreign competitors. Both India and China, for example, have strongly encouraged their companies to adopt stock option programs and have clearly indicated they would not adopt the sort of accounting for stock options being proposed here in the U.S. While I understand that FASB holds itself above the political playing sphere and wants to do what it considers best regardless of the political consequences, I believe this view is short-sighted. Such wrong-headed action in the past nearly led to action by congress to override the FASB, something that would have irreparably damaged a body for whom I have great respect. I am aware of many initiatives currently under way which might have the same effect, including a measure currently picking up steam in Congress to expense only options given to the top 5 employees in a company. I can understand the political attractiveness of this solution, but it makes no accounting sense. Its only advantage is that it would counter much of the momentum behind current efforts, which we all know stem from abuses at companies like Enron and Global Crossing.

Don't let this happen to our profession! Let's not settle for bad accounting! Please take a step back and re-evaluate the proper way to deal with employee stock options. Don't try and fix a system of accounting and reporting for stock options that is not broken. The current rules requiring inclusion of the dilutive effects of options on the face of the income statement as part of the EPS calculation is well proven and completely appropriate. Recent rules requiring enhanced footnote disclosure of their hypothetical income statement effect for those interested is also appropriate, giving investors information they might want without introducing highly subjective numbers that are not accurate, meaningful or relevant onto the face of the income statement.

In light of the many serious negative consequences that would result from mandated expensing of employee stock options, a more sensible course would allow the current disclosure rules to work as they were intended, while continuing to evaluate the situation and perhaps supplementing the rules with new, more investor friendly disclosures, if needed.

Thanks and best regards,

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