



Letter of Comment No: 5844
File Reference: 1102-100

June 30, 2004

Ms. Suzanne Bielstein
Director of Major Projects
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Re: File Reference No. 1102-100

Dear Ms. Bielstein:

AeA appreciates the opportunity to comment on the Exposure Draft of the Proposed Statement of Financial Accounting Standards *Share-Based Payment, An Amendment of FASB Statements No. 123 and 95*. AeA is the nation's largest high-tech trade association and represents more than 3,000 companies with 1.8 million employees. These 3000+ companies span the high-technology spectrum, from software, semiconductors, medical devices and computers to Internet technology, advanced electronics and telecommunications systems and services. AeA's member companies utilize broad-based stock option programs to attract and retain a highly skilled workforce and will be directly affected by the FASB's proposed rules.

AeA firmly believes that mandating the expensing of employee stock options will have serious and widespread economic and labor consequences, and will effectively result in many companies terminating broad-based employee stock programs; however, because we understand that the FASB does not consider such factors when formulating accounting standards, this comment letter will only focus on accounting issues.

As we have stated in previous comment letters, AeA believes that it is wrong to characterize employee stock options as an expense. Any attempt to mandate the expensing of options would result in misleading and imprecise information because there are no models that can accurately compute a "cost" of the options. The valuation models that the FASB proposes only serve to render the accounting statement more subjective: companies will be forced to rely on speculative valuation methods in order to "foresee" the future cost of an option. In particular, for companies that have recently gone public and whose stock is still highly volatile, this method of calculation is highly problematic.

At the time of grant, stock options have no realizable or attributable value; they are subject to contingencies, and their future value is speculative. As such, stock options are not an expense because they do not reduce the net assets of a company. The value of company shares is diluted,

but the company's total value is unchanged. In effect, FASB's proposed changes undermine a key principle of accounting: the link between the balance sheet and the income statement.

AeA believes the real issue for investors is the dilution caused by stock options, and information relating to the potential dilutive effect is already provided to shareholders. For profitable companies, the dilutive effect is included in the calculation for earnings per share, and we are concerned that the FASB's proposal would cause a double counting of the impact of options on earnings per share. Current accounting standards already require companies to provide detailed information on stock option grants in footnotes to financial statements. These disclosures include descriptions of the impact stock options have on earnings per share and the company's diluted earnings; as such, investors are provided with the substantive financial information they need in order to judge for themselves what impact option grants might have on the financial performance of the company. Replacing this data with a number representing the "cost" of options will diminish the amount, reliability, and accuracy of the information given to investors.

Expensing options would neither provide investors with additional information, nor add clarity to financial statements. If anything, it would make financial statements more confusing, and the sheer number of calculations involved in estimating the future volatility of an option would only serve to make the statements less transparent. Additionally, the subjective judgments necessary for calculating the potential cost of the option would have no model for consistency. This would make comparisons between companies impossible and would only open the door for accounting manipulation. By making the expensing of options mandatory under the proposed models, the FASB has essentially facilitated the exploitation of the same issue it was trying to eliminate.

Furthermore, there are no proven models that can accurately compute an option's cost. There has been no systematic study of the efficacy of the Black-Scholes model or any other valuation model when applied to long term, unvested, non-tradable, and non-transferable employee options. The existing valuation models were developed to price very short-term, publicly traded options which are exercised on expiration.

The binomial lattice model that the FASB recommends does not provide a better method for estimation, but rather only allows for greater subjectivity. The approach is highly complex and has been criticized as unworkable. Since most businesses still prefer the Black-Scholes model of valuation, a switch to the binomial method would prove to be both costly and time-consuming – something that is exacerbated by the fact that binomial software tools do not appear to be widely available.

The value of options included in a broad based plan (which would include most, if not all, employees in a company) simply cannot be determined using a spreadsheet. Many companies are currently working on updating their software to include a way to value options, but to date, new tools do not appear to be available. It is not feasible to implement a standard when there is no way to accurately compute the expense required. Companies need time to evaluate the standard, purchase new tools to support it, train staff, and then implement the standard. This cannot be done in the current time frame proposed by the FASB. Smaller companies will also be

disproportionately harmed because they have even fewer resources to comply with these proposed rules.

There are additional faults with both models. Since neither method takes into account the unique attributes of employee stock options, both Black-Scholes and the binomial model systematically overstate the value of the option. Moreover, neither method provides a specification for estimating expected volatility. Unless volatility is input as zero, there remains no identifiable way to create consistent and reliable calculations from company to company. The lack of an accurate valuation model and the inability for cross-comparison due to the subjectivity of volatility calculations would enable different accountants to calculate substantially different values for options, thereby opening companies up to lawsuits.

Despite the absence of a tested model that accurately predicts volatility and expected option lives, the FASB does not provide for an accounting correction or truing up mechanism. Unlike many other accounting estimates, these initial estimates are not subject to revision as actual stock volatilities and option lives are revealed. Even if the stock option expires and is never exercised, the expense would still remain on the books although no economic transaction had occurred.

Additionally, employee stock purchase plans (“ESPPs”) have unnecessarily become swept up in the stock option expensing debate. The primary purpose of ESPPs is not to compensate employees for services rendered, but to encourage employees to become shareholders. Because no corporate assets have been used up nor has their value diminished as a result of ESPPs, we do not agree that they should be counted as an expense.

Stock option and ESPP expensing is an issue that disproportionately affects the high-tech industry. While many companies that currently expense only grant options to their top executives, high-tech companies routinely provide such benefits to a majority – if not all – of their employees. For companies that grant options to the majority of their employees, use of the proposed valuation models would result in material errors in their financial statements, errors that perhaps would be insignificant if a company only granted options to a handful of executives.

For the reasons stated above, we believe the FASB’s proposed changes would create substantial accounting confusion – for companies and investors – and we urge the FASB to conduct comprehensive market-based testing of the proposed valuation models before proceeding further. In addition, the FASB has indicated that actuaries are able to predict future employee behavior with regard to exercising stock options, and we urge the FASB to document meaningful studies to ensure that this is the case because many of our companies are concerned with having to make this prediction when calculating the value of stock options.

Should the FASB proceed with its proposed accounting changes, we respectfully request that it delay the proposed implementation date. In addition to the uncertainty as to the availability of a binomial software tool and the substantial financial burden that will be attributable to complying with these proposed rules, companies are currently working on implementing the internal control requirements under the Sarbanes-Oxley Act's Section 404. Corporate finance departments are focused on proper and complete compliance with Section 404 at this time, and we believe

because financial resources are limited, companies would have difficulty properly implementing the FASB's new rules during the same time frame.

Thank you for your time in considering AeA's comments.

Sincerely,

A handwritten signature in black ink, appearing to read "William T. Archey". The signature is written in a cursive, flowing style.

William T. Archey
President and CEO