



Letter of Comment No: 5796
File Reference: 1102-100

June 30, 2004

Via Email

Ms. Suzanne Bielstein
Director of Major Projects – File Reference 1102-100
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: Proposed Statement of Financial Accounting Standards Share-Based Payment, an amendment of FASB Statements No. 123 and 95

Dear Ms. Bielstein:

IDT offers its comments on the Proposed Statement of Financial Accounting Standards, Share-Based Payment, an amendment of FASB Statements No. 123 and 95 (the "Exposure Draft"). IDT is a global leader in preemptive semiconductor solutions that accelerate packet processing for advanced network services. IDT serves communications equipment vendors by applying its advanced hardware and software technologies to create flexible, highly integrated solutions that enhance the functionality and performance of network equipment. IDT employs over 1,200 people in the United States, and we grant employee stock options to the vast majority of them. We welcome the opportunity to comment on the Exposure Draft.

IDT believes it is essential that corporate financial statements not only present relevant information to investors and other users of the financial statements, but that such information also be reliable and comparable for all reporting companies. We do not believe that the Exposure Draft fulfills this critical requirement.

Not A Reliable Means To Value Employee Stock Options

The Exposure Draft proposes that the "fair value" of all employee stock options be recognized as an expense in the income statement. It goes on to define "fair value" by using a willing-buyer/willing-seller standard. Unfortunately, the use of existing option models will not produce an expense that represents the fair value of an employee stock option.

Neither Black-Scholes nor binomial or lattice models was designed to value employee stock options. Instead, they were designed to value freely tradable options, which are very different financial instruments. Unlike freely tradable options, employee stock options are subject to vesting and cannot be transferred. Existing models do not take into account these unique attributes.

In addition, the predictions that are required inputs when using such models are problematic. Predicting employee exercise behavior and interest rates 10 years into the future is essentially impossible. In addition, the single greatest determinate of option value under these models is volatility. The underlying assumption of the Exposure Draft, that historical volatility is not necessarily a valid indicator of future volatility, is correct. However, requiring companies to predict their volatility 10 years into the future is impossible. Undoubtedly, similarly-situated companies will take very different approaches in trying to solve this impossible task, making it more difficult for investors to compare results on a level playing field. It also raises substantial Sarbanes-Oxley issues for CEOs and CFOs who now have to certify corporate financial statements. Equally important, it raises issues as to how auditors will be able to audit the company's determination of what future events are likely to occur and what the impact of those events will be on the volatility of the company's stock.

We also note that there has been no testing of the binomial models now preferred by the FASB. It was only after being able to analyze many years of data that the FASB reached the decision that Black-Scholes did not and could not produce a reliable valuation of employee stock options. We believe the same will be true with binomial models, but, at the least, the Board should engage in extensive field testing of these untested models before mandating a change in current accounting principles.

Materiality Concerns

For companies that do not issue broad-based employee stock options, the concerns about expensing are quite minor. Indeed, virtually all of the companies that have elected to expense to date do not have broad-based stock option plans. However, for a company like IDT which grants options to a large number of its employees, the issues are acute. Where the potential expense is material, significant issues arise concerning the reliability of the financial statements. The fact that small changes to assumptions can produce wildly different expense figures illustrates why the Exposure Draft's proposal is so problematic. In addition, companies could experience material changes in their reported earning depending on their current stock price and the assumptions used in the option pricing model, even though the financial health of the company remains unchanged. We do not believe that this will provide better, more reliable, or more comparable information to investors.

IDT believes that the true cost of employee stock options is in the potential dilution to existing shareholders. Rather than mandatory expensing, we favor detailed disclosure of all relevant information. Given that there is no agreement as to whether the granting of employee stock options constitutes an expense, a disclosure standard provides all investors with the information they deem relevant.

Employee Stock Purchase Plans

The Exposure Draft asks whether employee stock purchase plans ("ESPPs") are non-compensatory if the employee is entitled to purchase shares on terms that are no more favorable than those available to all holders of the same class of stock. IDT clearly believes that such ESPPs are non-compensatory. However, we also believe that other types of ESPPs are non-compensatory. IDT believes that the current rule of APB No. 25, which follows the tax rules as to what level of discount is considered non-compensatory, should be retained. This rule is well-understood, simple, consistent, and also recognizes the fact that the company has a significant cost savings when employees purchase unrestricted stock through an ESPP.

In closing, ESPPs and employee stock options are the fundamental tools that we use to attract, motivate, and retain our employees. As discussed above, we believe there are significant technical problems with the Exposure Draft and that mandatory expensing of an unreliable and material number will, in the end, force many companies like us to abandon the tools that have fueled the tremendous economic growth in the United States.

We thank you for the opportunity to comment on this important subject.

Sincerely,



Clyde R. Hosein
Vice President and Chief Financial Officer

Cc: Greg Lang, President and Chief Executive Officer