tensilica

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Dear FASB Members,

I am writing on behalf of Tensilica, Inc., a private technology company based in Santa Clara, California. My company is seven years old and has 100 employees. I am writing in response to your request for comments on proposed new rules for expensing stock options.

Let me first make clear that my company strongly opposes the expensing of stock options. These are non-cash awards that are already adequately disclosed in financial statements. The dilutive effects are reflected in the income statement and are well understood by users of such statements. My company believes that adding options-related expenses directly to the income statement would have the effect of diminishing option grants in the future, primarily for rank and file employees. This is bad public policy. Silicon Valley and other technology centers are major engines for U.S. economic growth. New companies and industries develop here and stock options are an important ingredient for that growth. Today, 100% of my company's employees receive stock options. If stock option expensing is required, my company will be motivated to limit stock option grants to only the most senior employees.

Stock option expensing is fraught with error, arising both from the use of inappropriate stock option valuation models and from the many assumptions required by them. For public companies, the resulting differences that will occur from one company to another will make financial statements *less* useful for comparing companies rather than more so. As a private company, showing option expense in the income statement does not help the private investors in my company, nor does it help employees.

As a private company with a small finance staff, the proposed new rules regarding stock option expensing are so complicated as to be overwhelming. They will force us to hire more accountants. Every accountant we hire means we hire one fewer engineer. This is not good for my company or for the economy.

In order to assign a value to stock options, a large number of assumptions must be made. These are difficult enough for public companies but even more so for private companies. They will result in expenses on the income statement which will distort and confuse financial results rather than adding clarity. Let me expand on a few of the assumptions my company will be required to make.

1. If stock options are to be expensed, they must have a fair and accurate value assigned to them. The only real value is the market price, but these options cannot be bought or sold, so a market price does not exist. Instead of a market price, complicated models must be used, such as Black Scholes, which were never designed for this sort of stock option. For example, these models do not account for the typical restrictions on employee stock

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options, such as restrictions on transfer, hedging, pledging and sale. We should not be basing financial statements on inappropriate models. While the use of assumptions and judgments is common in financial statements, nowhere else are they combined with inappropriate models in such a way.

2. Stock option valuation models require that stock volatility be estimated. How can a private company do this? Our stock is not traded. Instead, we have to try to find a "comparable" company. But it is hard to see how a private company can be considered comparable to a public company. Further, we must then estimate volatility up to 10 years into the future. We certainly can't forecast our sales or expenses out that far, so it is hard to see how we can forecast our stock volatility when we aren't even public yet.

3. Private companies are required to estimate how long employees will hold their stock options. Employees can't sell stock until after an IPO. But we are not in a position to forecast the timing of our IPO, or even if it will occur. Therefore, it is hard to see how we can estimate stock option holding periods accurately. Furthermore, we are required to estimate holding periods for different classes of employees (By age? By gender? By function? By level?) This makes the process even more difficult and makes the resulting stock option valuation that much less meaningful.

4. When options vest on a "graded schedule", each set of options must be valued separately and accounted for separately. A typical stock option grant vests monthly over 48 months. This means that 48 different "option grants" must be valued. With 100 employees in my company, each of whom has an initial grant upon hiring plus 1-2 follow-on grants, this means that *my small finance team must value well over 10,000 option grants*. This is overwhelming. We are already struggling with Sarbanes-Oxley.

5. Given all these difficulties, I may conclude that it is impossible to a) estimate the fair value of employee stock options, b) get the company's auditors to sign off and c) comply with Sarbanes-Oxley. If this happens, I will then be required to use an intrinsic value method, where value is adjusted in each reporting period. This is variable accounting, which increases the workload further and makes the income statement even more distorted. For example, in periods of declining stock price, variable accounting could result in a credit to the income statement. It is difficult to understand how this would be helpful to my company's investors.

It is entirely reasonable (inevitable, in fact) to expect two companies to make very different assumptions in all of the above areas, thereby creating two very different income statements. How is an investor or potential investor supposed to benefit from this?

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In summary, my company's position is as follows:

- Stock options should not be expensed to the income statement. Doing so will result in fewer options being granted to rank and file employees.
- The complicated and inappropriate stock option valuation models proposed will make it harder to understand and compare company financial results.
- The stock option valuation models proposed are particularly inappropriate for private companies.
- The efforts required to comply with this proposed new standard are overwhelming for a small company and provide no value to its investors.

Thank you for your consideration.

Sincerely,

Keith Van Sickle
Chief Financial Officer