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29 June 2004

Re: Exposure Document, Share-Based Payments (an amendment of Statements No. 123 and 95)

Dear Director:

The Small Business Technology Coalition wishes to comment upon the above captioned Financial Accounting Standards Board proposal. SBTC is the nation's oldest and largest organization of small technology companies from diverse fields. We are a non-partisan, nonprofit industry association of companies dedicated to promoting the creation and growth of research-intensive, technology-based U.S. small business. We are also the technology company council of the National Small Business Association. Founded in 1937, NSBA is the oldest nonprofit advocacy organization for smaller companies in the United States. It serves 150,000 businesses in all 50 states.

In the referenced Exposure Document, FASB proposes that all share-based payments to employees, including future stock options, be treated as identical to cash compensation and so recognized in a company's financial statement. Companies whose stock isn't publicly traded -- that is, most companies -- would be required to establish a value for the stock using complex formulas. Since few if any smaller accounting firms are conversant with these formulas, most affected companies would need to bring in consultants or Big Four accounting firms to do the required calculations of value.

SBTC opposes this one-size-fits-all rule.

For one thing, small private companies are not the source of the national controversy about the incorrect valuations of stock options. Big publicly-traded companies are. For another, it is extremely difficult and costly to set a value for stock options in small private companies, especially those that have no intention of going public in the foreseeable future. Even attempting to comply will likely cost smaller companies tens of thousands of dollars in consulting and accounting fees. This is money these companies can't spare; it will leave them cash-strapped for innovating and hiring, which is what the nation needs them to do.

And what purpose will the rule achieve when applied to small private companies that are, at best, years away from going public? Providing some hypothetical investor with a set of notional numbers that, by almost universal agreement, substantially misrepresents such a company? Illuminating the unknowable -- what a company's finances will look like five or ten years down the road, when every single figure in its financial statements will have changed? Communicating to a company's employees the misleading perception that their illiquid stock options are fundamentally similar to General Electric stock options?

This is going to promote public trust in the accounting profession?

A Council of National Small Business United

If the current system -- as it applies to such small private companies -- is harming investors, where is the evidence? Where are the victims?

What the expensing of stock options *will* do to these small private companies is this: It will arbitrarily, artificially pull down their asset values and balance sheets. It will turn positive equity into negative net worth. Without changing a dollar of income, it will transform healthy companies into money-losing ones. It will make the companies look unbankable to lenders. It will cause banks that do lend to them to be harassed by bank regulators. It will get the companies classified as "not financially feasible" by government agencies, making them ineligible for government awards and contracts. And it will have unforeseeable and potentially damaging tax consequences.

Faced with an array of negative consequences like these if they offer stock options, what will small technology-based companies do? What will their accountants, attorneys, and financial advisors urge them to do?

Don't offer stock options! That will be the drumbeat.

This will amount to a sea-change in the economic environment for small technology companies. Shared equity is the key economic incentive that gives smaller companies a comparative advantage over larger ones in attracting highly skilled science and engineering talent. Destroying that incentive without offering anything to replace it will have sweeping downstream economic consequences. A sector of the economy that has historically provided the nation with cutting-edge innovations in information technology, defense, biotechnology, manufacturing – and, more recently, homeland security – will be dealt a sharp blow.

For small private companies, the proposed FASB rule is a "cure" that is a hundredfold worse than any "disease" it purports to treat.

It did not have to be this way. When federal agencies regulate business, they are required by law to consider whether smaller companies can and should be treated differently than larger ones. (5 USC § 601 *et. seq.*) But the FASB, as a "self-policing" organization of the accounting industry, is not a federal agency. Still, given the force of its rules, the FASB ought not to ignore the standard federal procedure.

SBTC agrees that FASB has a vital role to play. It is responsible for establishing, interpreting, and backing the accounting standards for our nation's companies.

That is an important duty. But in handling that duty, FASB should demonstrate the same kind of <u>transparency</u> and <u>thoroughness</u> that it asks of accountants and of company balance sheets.

If we were "auditing" the FASB rule, we would note these defects:

Transparency. FASB's hand-picked small business advisory group was created only after Congressional criticism of the lack of small business input. The group met -- with little advance notice -- after the stock option proposal had already been published.

Thoroughness. In the 229-page description of the proposed rule, there are two passing references to small business. There has been no legitimate outreach to affected smaller companies, let alone an examination of the issues such an outreach effort would have uncovered.

The kinds of questions that a federal agency would have had to ask itself, and which FASB ought to have asked itself, include:

1. What are the public interest issues at stake that warrant including small private companies in this rule -- for the public, for investors and for entrepreneurs? How can any conflict among these public interest issues be balanced?

2. How and to what extent do small private businesses contribute to the stock option problem?

3. Will the proposed rule stimulate or hinder the growth of small business?

4. If it is likely to hinder that growth, can the rule be designed to eliminate this risk to the economy without compromising the public interest?

5. Shouldn't FASB *generally* develop less burdensome rules for smaller companies that will not be going public within a one to three year time horizon?

SBTC hopes that it will not have to seek legislation to correct FASB's course. But we are prepared to pursue that option if this rule is not changed.

Sincerely,

Jere W. Glover
Executive Director