

Letter of Comment No: 5774

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Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, Connecticut 06856-5116

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

Our firm has been successfully investing in technology companies for over 40 years. We are sophisticated users of financial statements for both private and public companies of all sizes. We have reviewed the FASB Exposure Draft on Share Based Payments and are pleased to offer the following comments:

- 1. Transparency of financial statements would be dramatically reduced by the Exposure Draft. The Exposure Draft would result in a myriad of different approaches for both private and public companies, creating obfuscation of true results of operations. Some firms would use the intrinsic value method; others would use the lattice model. Firms would use dramatically different assumptions in their lattice model constructs. The end result would be total distortion of firms' income statements due to lack of transparency and lack of consistency among companies, and no true ability to compare results of operations of different companies. The fair value measurement objective would not be met with any consistency; however, use of the intrinsic value method would make this problem even worse.
- 2. The current Statement 123 pro forma disclosure provides a better level of transparency than the proposals contained in the Exposure Draft. The current pro forma disclosures allow investors to evaluate the investment's results of operations on a post-expense basis if they desire.
- 3. The grant date is the only viable measurement date for any value assigned to stock options as this is the date of the underlying transaction with the employee.
- 4. The Exposure Draft use of option pricing models to value stock options granted to employees is flawed. Use of these stock option pricing models would result in a material violation of the fundamental GAAP standard that fair values be determined by the value assigned by a willing buyer and a willing seller. In the case of an employee stock option, the true determinant of

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fair value is actually the value ascribed to the option by the employee. Each of the option pricing models fails to properly take into account the fact that employee stock options are unique due to their lack of transferability, and for private companies, their total lack of liquidity. I suggest that further studies be performed to compare the value of options determined using the pricing models to the perceived value of the options from the perspective of the employees receiving the option grant. In nearly all cases, the perceived value by the employee would be materially below the value that would be determined by the option pricing models. This conclusion is supported by the JP Morgan/Microsoft employee stock option transaction. More work is required to ensure that any valuation model that is used provides reasonable estimates of fair value.

5. The current proposals are incredibly onerous for small companies. Most small companies have limited finance staff and would incur large costs of compliance with the Exposure Draft. A typical small technology company has an accounting staff of 1-3 people. The requirement that the lattice model be used for all option grants is simply not feasible for companies of this size. Further, the requirement that companies perform groupings of employees for purposes of predicting exercise behavior is feasible only for the largest US companies.

I appreciate that the topic of expensing stock options is a very complex issue with wide-ranging consequences. I am sure you are aware that 30% of the growth of the US GDP comes from the technology industry. While this fact does not preclude changes under consideration to the accounting for stock options, it does suggest that great caution be applied to ensure that the proposed solutions are viable and the impact on the United States economy is well understood prior to finalization of any changes in stock compensation accounting principles.

Respectfully,

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