



January 30, 2003

VIA E-MAIL

Financial Accounting Standards Board
MP&T Director – File Reference 1101-001
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Letter of Comment No: 237
File Reference: 1102-001
Date Received: 1-30-03

**Re: File Reference No. 1102-001: Invitation to Comment on Accounting for
Stock-Based Compensation**

Dear Sir or Madam:

The Semiconductor Industry Association (SIA) appreciates the opportunity to submit comments for consideration as the FASB considers whether to propose any changes to the U.S. accounting standards on stock-based compensation. The SIA represents over 90 percent of the U.S. semiconductor industry – our members represent the largest semiconductor makers in the United States¹. We believe the current FASB standard, adopted by the Board in Statement No. 123, is an appropriate standard for stock options. SIA and its members believe providing the investing public with transparent, accurate and comparable information is of paramount importance and any changes to the rules should bolster this goal – we do not believe that expensing options would lead to more accurate or transparent financial statements because of the inability of current models to reliably and correctly value employee stock options. SIA also has concerns about the impact a potential expensing rule could have on our competitiveness.

Accountants in academia, the private sector and the public sector have yet to agree on the question of how to value stock options. Existing option pricing models, such as Black Scholes and binomial models, were not designed to predict the value of employee stock options and are unable to generate consistently accurate valuations. Black Scholes does an excellent job of predicting the prices at which short-term, minimally restricted options will trade in the open market. The Black Scholes and binomial models, however, do not provide reliable estimates for options of one or more years in duration. The adjustments to Black-Scholes and binomial models proposed by the IASB are insufficient to address this issue fully. Employee stock options have durations of five to 10 years, do not vest immediately, are contingent on continued employment, cannot be sold and are subject to various other restrictions including forfeiture – all of which makes them difficult to value using the Black-Scholes model. In addition, these models

¹ The Semiconductor Industry Association (SIA) is the leading voice for the semiconductor industry and has represented U.S.-based manufacturers since 1977. SIA member companies comprise more than 90% of U.S.-based semiconductor production. Collectively, the chip industry employs a domestic workforce of 284,000 people.

require inclusion of an estimate of future stock volatility – this piece of the model has generally has the largest impact on the valuation model, and is wrong far more often than it is right. SIA and its members believe that it would be highly inappropriate to introduce an expense into company financial statements that is based on such an inaccurate valuation.

The FASB is reportedly considering the creation of a “Valuations Advisory Group” to address valuation questions. The work of such a body should, in our view, not only commence but conclude its work before there can or should be any additional work done on the issue of expensing. Ultimately, any new rules must be based on a uniformly accepted valuation methodology.

Employee stock option grants differ from third party grants in that third party grants increase liability and equity equally. SIA agrees that in the context of third party payments, the expense to be recognized should be the fair value of the goods and services received, *i.e.*, the cost to the company and not the value of the equity instruments in the hands of the recipient. These transactions create a specific liability and include some independent means of valuing the goods or services provided to the company granting the options or issuing the stock. The granting of employee stock options does not result in the creation of a quantifiable liability and leaves the employee with no claim on the assets of the firm – instead, they represent a means of allowing employees to reap the rewards of ownership. As a result, the granting of employee stock options does not meet the accounting definition of an expense. Instead, options represent dilution of ownership.

The members of SIA believe that options represent capital, rather than labor income. SIA members must compete in a global market for talent, and we must pay our employees regular market wages. Options are granted on top of regular wages, not as a substitution for normal income. In fact, semiconductor industry workers have historically been paid more in regular salary income than employees in other manufacturing industries on average – while at the same time our members grant between 80-95% of options to those below the executive level.

The broad and deep dispersion of options within SIA member companies makes potential inaccuracies in valuation more troubling. Companies that issue only a small number of employee stock options – typically to top executives – will be less sensitive to inaccurate valuations being included in their financial statements because those numbers may be so small as to be immaterial. This situation appears to characterize many of the companies that recently chose to expense their employee stock options. SIA members, though, grant options to a large segment of their workforce and so fear the inclusion of a large, inaccurate expense. With the same number of options outstanding, companies could experience wild fluctuations in their reported earnings – these fluctuations would have no relation to the financial well-being or performance of the company.

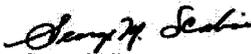
SIA members believe that current accounting rules rightly require detailed disclosure on option grants, including their potential dilutive effects. Market share prices directly reflect diluted earnings per share, therefore the cost of stock options is already reflected in the market price of stock. Impact on earnings per share and dilution caused by option grants, therefore, is information that should be made available in a consistent manner to shareholders. If an additional expense was added – in addition to calculating dilution – the effect of options grants would essentially be counted twice.

The recent decision FASB took to allow three different transition rules for companies choosing to expense options was clear evidence that this issue has differential impact on different firms. We applaud the Board for showing this appropriate flexibility and encourage you to retain this flexible approach to Statement No. 123. SIA members are aware of the benefits that could result from the adoption of globally accepted accounting standards. However, the proposal being considered by the IASB does not represent convergence on a tested and workable standard, and we believe it will not help ensure accurate, timely and transparent financial statements.

We would also like to reiterate that in our industry, stock options are routinely given not only to executives, but also to those well below the executive level – as already noted, 80-95 percent of options are granted by our members to those below the senior executive level. Options allow us to insure that our employees are able to fully share in the success they have helped make possible. In addition, they are a key means by which we attract and retain our best employees. Our members are engaged in constant global competition for the best and brightest engineers from around the world and we must offer those employees the potential to enjoy the success they help generate through an equity stake – requiring expensing would severely limit our ability to compete for talent through such equity participation.

The current FASB standard is a workable and effective means of providing investors with precise information, and it avoids the inclusion of potentially misleading expense charges in company financial statements. The disclosure-based standard embodied in FASB Statement 123 is the best approach to employee stock option accounting. I would be happy to answer any questions you might have regarding our position.

Sincerely,


George Scalise
President