January 31, 2003

Letter of Comment No. 235
File Reference: 1102-001
Date Received: /-3/-03

Via email and FedEx

MP&T Director – File Reference 1102-001 Financial Accounting Standards Board 401 Merritt 7 P. O. Box 6116 Norwalk Connecticut 06856-5116

Dear Sir or Madam:

RE: <u>File Reference No. 1102-001: Invitation to Comment on Accounting for Stock-Based Compensation</u>

We write today to urge that the Financial Accounting Standards Board not change its existing standards with respect to stock option accounting. While the IASB recently has announced its views on this matter, we find the rationale underlying their approach to be fundamentally flawed. Adoption of such an approach in the United States would undermine the integrity of financial reports issued by US companies.

Altera Corporation is a leading manufacturer of programmable logic devices. Our sales of these semiconductor devices totaled \$711 million in 2002. We employ approximately 1850 people and have long sponsored a broad-based stock option plan that covers all of our employees. Our success as a pioneering high-technology company derives in part from a financial reward structure that explicitly links, through stock options, changes in shareholder value to the compensation of our employees.

The changes advocated by the IASB most certainly would lead to the reduction or elimination of plans such as ours. Even worse is that these harmful consequences flow from an IASB accounting solution that will produce lower quality and less reliable financial reports.

As embodied in the IASB proposal, the central issue facing FASB is whether financial reporting should reflect an expense to the issuer at the time an option is granted. Options, at the time of grant or even exercise, do not reduce the value of the enterprise. To consider them an expense is therefore unreasonable. This situation is entirely different than is the case with the payment of employee salaries or the purchase of goods or services, which do reduce an asset (cash) of the corporation and rightfully these transactions do appear on a company's income statement as an expense.

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An employee stock option may be valuable to the employee at some time in the future, but the cost to the company is a cost only to the company's shareholders, borne through dilution of their ownership. Shareholders, who by regulation, must approve employee option plans do so with an intent to create greater alignment between their interests and those of the company's employees. Their hope is that the existence of such a plan will create superior returns more than offsetting to the dilution they have approved. If they believe a proposed plan does not meet those objectives they are empowered to turn the plan down. The relevant question is not whether stock options are an expense but instead whether stockholders are provided sufficient information to determine the extent of dilution arising from a company's option plans.

Under current accounting standards and SEC requirements, potential stock option dilution faced by shareholders is fully disclosed in table format and a company's earnings are adjusted to reflect potential dilution as well. There is nothing hidden. We believe that full and ongoing disclosure of option activity to shareholders is the only proper course. We have recently taken the additional step, as have many other high-technology companies, to place in our quarterly SEC reports, information that previously was required to be disclosed annually. In addition we include a variety of other option statistics that capture the operation of our plan.

There are other shortcomings to the IASB approach. In its attempt to create an option expense, the required fair value option expensing calculation advocated by the IASB requires the use of an option pricing model and ignores the serious shortcomings of the models available. Designed to calculate the value of freely tradable public options, none of these models adequately capture the unique dimensions of employee options that are not tradable and vest over several years. Further, all of these complex models require the use of various estimates and projections that will inevitably lead to lack of comparability between issuers – simply because different degrees of conservatism or liberalism are embodied in the assumptions chosen.

There are in use today a number of financial models that can ascribe a fair value to an option. We do not believe that the "fair value" standard represents fair value of an employee option. The most often referenced option pricing model, Black-Scholes, is highly sensitive to the issuer's

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current market price when assigning a value to an option. It is well known that Black-Scholes values change linearly with current share price. In our case, since our share price declined more than 40% during 2002, the Black-Scholes calculated value for an otherwise similar option has changed significantly. Swings of such magnitude can only serve to distort financial reports.

We believe that FASB's current approach and the pertinent SEC and stock exchange regulations contain more than adequate information to allow shareholders to make an informed assessment of a company's option practices and posture. FASB is at risk of solving a problem that does not exist for the users of today's financial reports and even worse, the IASB proposals suggest very problematic alternatives that would degrade that usefulness of financial reports.

We suggest that FASB consider the considerable merits of its current approach as it evaluates the wisdom of the IASB alternative. In our view, the IASB proposals are seriously lacking.

Sincerely yours,

Nathan Sarkisian Senior Vice President and Chief Financial Officer Altera Corporation 101 Innovation Drive San Jose, CA 95134