

January 31, 2003

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

Letter of Comment No: 102
File Reference: 1102-001
Date Received: 1-31-03

Re: File reference 1102-001/Comments on stock-based compensation/Issue no. 17

Gentlemen:

I wish to tender a response to Issue No. 17, as identified by your invitation to comment. That item asks about disclosure and the economics of stock-based compensation.

Since the invitation to comment is complete with examples, let me offer one of my own:

Example: A business is started with a \$1,000 investment, and all of the ownership resides in the hands of an individual. That business quickly grows and generates profits of \$2,000 (before stock options). The \$2,000 is paid to the owner in the form of dividends. In addition, employees have been granted options with a fair value of \$2,000 (the stock is valuable because of the enterprise success). Under the various fair-value concepts, the proposal to expense options would have us report no profit (\$2,000 - \$2,000). Gentlemen, what is the \$2,000 in the owner's pocket?

Key Point: Wealth and income are not the same thing. Accountants largely measure income based on transactions and events, while options are about wealth creation and distribution -- to "match" the attribution of wealth with the measure of income is to hopelessly commingle two completely different concepts.

Core of the problem: Accounting was invented when Italy was the center of the flat world, and the "entity" was the central focus of measurement. Now, the world is round and you must triangulate to find where you stand. Likewise, business is more complex -- in the case of options you involve the company, the employee, and the shareholder -- and triangulation of reporting is needed to reveal the option effect. Options are shareholder transaction (a redistribution of ownership); the company (whose assets and liabilities are not involved (with the exception of the option price itself)) is merely the conduit vehicle.

Solution: A 5th financial statement is needed -- a statement of distribution and redistribution -- that reveals the level of option activity (and related ratios, etc.) and the employee disposition of such options --- that is what an investor wants to know.

I cannot emphasize enough the importance of this issue. Accounting is about providing information that fuels the capital formation process. In my 20+ years as an accounting professor, I have never seen us flirt so dangerously with a measure that will distort the performance signaling process. I fear that capital formation will be damaged.

I would respectfully ask you to rethink the entire premise of the prevailing view. Thank you.

Very truly,

Larry Walther
P.O. Box 33346
Fort Worth, TX 76162

lwalth@lwalth.com