

Stacey Sutay

Subject: FW: Expensing of Stock Options

-----Original Message-----

From: John Hughes [mailto:johnhughes@cygnethealth.co.uk]

Sent: Sunday, April 11, 2004 9:09 PM

To: Director - FASB

Cc: Craig Hughes; Ken Wilson (Ken Wilson)

Subject: Expensing of Stock Options

Portola Valley CA

10 April

Dear FASB Person,

Thank you for the full page ad in Barron's with the invitation to comment on your proposals.

I disagree strongly with your USA and international move to expense the value of share options. I believe that earnings per share need to be shown with 100% transparency of the DILUTION options cause but describing them as an expense of the enterprise will cause freakish obfuscation of trading reports....an unintended perverse result.

The concept violates the three key principles of accountancy.

I am the major (64%) shareholder of a privately held UK hospital group - Cygnet Health Care Ltd -- which will earn \$20 million EBITDA this year. I am the GRANTOR of share options, not on the receiving end. So far we have issued options over approximately 7% of the company's shares and thereby secured the loyalty of about 20 key managers. Our key managers and our option scheme are hugely valuable to us.

Let me give you my reasons why you should temper your approach to this issue:

(1) Options are not a cash or cash equivalent medium...they simply dilute existing shareholders. The bookkeeping entries simply increase the divisor to calculate decreased earnings per share and decrease book value per share. They have no effect on the trading success or failure of the company. To book them as an expense in the P&L will confuse the small investor, not inform him. The cardinal rule of CONSISTENCY will be violated as year-on-year comparisons will be muddled -- both for single companies and comparing one company with another.

(2) Your proposed rules cannot smoothly match options with companies' trading results. They will cause irrational distortions in good years, bad years, and indifferent years. Our my small company, for example, a very large percentage of the outstanding options (about 3% of the equity) will become exercisable (and will be exercised for tax reasons) in September 2004, following a three-year holdback period required under our UK Inland Revenue qualified plan. We ladled out huge numbers of share options three years ago for valid commercial and tax reasons. So are you telling me to take a \$7 million "hit" off \$20 million EBITDA this year? \$7 million is roughly the above-water value our people will exercise in September. The result will grossly exaggerate the principle of CONSERVATISM

(3) What happens if a company's fortunes are reversed, where the company has taken big hits on unexercised options for a period of years, then has bad trading results? Do I get to prop up a filthy year by writing back through the P&L credits for options which expire "under water"? If so, your rules would

distort companies' P&L accounts MATERIALLY. They will also make them look worse in a booming stock market and perversely better in a tanking stock market.

(4) What happens if a company like mine, private but possibly heading for an IPO in 2-3-4 years, cleverly loads options for key people NOW and takes the meaningless hit to the P&L now? Then our key people roll up their share ownership under the privacy of a private company label, knowing that when (and if) we seek a public listing future options will dwindle to a tiny level to con the investing public by manipulating earnings upward. No, this does not make sense, but it's exactly the approach thousands of companies like mine will follow to circumvent your rules. Companies which can manipulate their plans prior to public listing visibility will have a large, untransparent advantage over companies stuck with older share incentive plans.

Isn't it clearer simply to add a line or two at the bottom of each P&L disclosing how much value optionees scored in the year reported? So Acme Widgets might report, eg:

	2004	2003
Net Profit After Taxes	\$ 33,590,000	\$ 26,560,000
Management Share Option Value Realized	2,300,000	1,220,000

This would allow the investor to reach a conclusion whether the option value realized was good value or not.

Finally, if you are bound and determined to require expensing of share options despite protestations, please consider doing this following conventional accounting practice which duffers like me can understand.

I'd call the item MANAGEMENT OPTION GOODWILL, with a detailed footnote in the accounts. That's what it is -- we are buying the "Goodwill" of the managers. You start the year with last year's balance, add the current year's option value realized, then amortize the balance over the useful life of the goodwill. Five years? Ten years? This will be argued between auditors and company boards. If the figures are not smoothed out over a number of years, nearly every company's financial results will be exceedingly lumpy and thereby make it awfully difficult to measure the true trading performance of one company against another.

Regards

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