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Sent: Wednesday, June 02, 2004 12:34 PM
To: Director - FASB
Cc: 'jcdowling@nvca.org'
Subject: File Reference No. 1102-100

Dear Director;

BTG Ventures feels very strongly that the proposed FASB rule changes are inappropriate for the following reasons:

- * Options are not expenses
- * Fair value methodologies not appropriate
- * Financial statements will become less clear
- * Venture-backed companies will suffer significant economic

harm

Options are not expenses

Quite simply, options are capital account transactions. Shareholders provide employees with an equity position in the company as an incentive to increase shareholder value. It is a direct transaction between shareholder and employee under which the shareholder elects to dilute its shareholding in order to achieve superior returns through enhanced productivity. Options do not consume a corporate asset nor do they result in a corporate liability. There is no measurable affect on profitability or cash expenditures. Options DO NOT affect profits, but they DO affect how profits are distributed among the shareholders. The distribution of profits is NOT an expense. Fair value methodologies not appropriate Neither Black-Scholes nor binomial approaches can reflect "any and all substantive characteristics" of an employee option. In addition to being highly variable, employee options have significant restrictions with respect to transferability and vesting. Even if such characteristics could be accounted for in the valuation, ensuring "that the fair value management objective is applied with reasonable consistency" would be an impossible task given the number of companies and option structures involved. All valuation methodologies are dependent on the quality of the variables used. In the vast majority of companies that issue options, the option valuation variables are highly speculative and inherently inaccurate. Most companies issuing options are private, illiquid, or very thinly traded. As such, market metrics of pricing and/or variability do not exist and companies will be required to derive the necessary inputs based on future projections. Most of these companies are new companies involved in emerging industries. Consequently, projections are extremely uncertain, the variability of a new industry compounding the variability of company performance. In the end, the calculation of fair value for any one of these companies will be inherently inaccurate, consistency across companies unrealistic.

Financial statements will become less clear

The inherent difficulty in fair value calculations will create substantial confusion about financial statements. Historical performance will be blurred by highly speculative and abstract projections about future performance, greatly reducing transparency and leading to inconsistency among companies. Investors will be forced to evaluate the underlying variables of the fair value pricing, a daunting task for any investor, and compare those to other companies. The result will be either significantly higher transaction costs and/or less educated investment decisions, negative results for investors. Importantly, expensing options creates confusion between the capital accounts and Income Statement. "Expensing" options implies that the cost has occurred and that investor returns in the future will not be impacted. This, of course, is inaccurate. In fact, investors' returns are NOT impacted until the future when the option is exercised and the shareholders diluted. This impact will be compounded by the timelines involved in which an option may be expensed up to 10 years prior to the economic impact on shareholders.

Moreover, the proposed guidelines require option expense to be balanced with paid-in-capital, creating additional confusion between actual capital invested and the PIC for options. As a result, not only will the Income Statement be in a permanent state of flux, but the balance sheet as well, leaving investors to ponder what is actual vs. restated. Income Statements exist to provide shareholders with an accurate reflection of historical company performance. Expensing options introduces market valuation and variability to the financial statements. This is the antithesis of accounting principals - financial statements should reflect actual results and not estimates of the future. Actual financial performance should affect market sentiment and valuation. Market sentiment

should not impact reported financial performance. Venture-backed companies will suffer significant economic harm. Venture-backed companies are an important part of the United States economy. The US's position in the global economy is dependent on innovation and entrepreneurship, which maintain competitiveness. Employee options are a critical component to encouraging innovation and entrepreneurship. Without options, the US's position in the global economy will be threatened. Employee options are essential to attracting highly educated and skilled employees to high-risk companies. Most of these employees sacrifice cash compensation, benefits, and career security. Without incentive-based options, the most skilled and valuable employees would not join entrepreneurial companies, leaving these companies uncompetitive in the global economy. Equally important, incentive-based options create a direct economic alignment between shareholders and employees, benefiting both parties. This link between employee and shareholder has been a critical factor in the success of US enterprises. It has resulted in more productive, more efficient, and more innovative organizations. It is no accident that the widespread use of options has coincided with the US's recent economic successes. A fact that has not gone unnoticed in emerging economies such as China, where options are being encouraged. Under the proposed guidelines, the use of options is likely to diminish significantly. First, options will create a substantial administrative burden. Complicated pricing mechanisms for each issuance of options combined with recurring revaluation exercises will require significant external assistance. Moreover, the governance burden placed on the BOD of directors will be substantial. The result will be an increased administrative burden and cost on already cash limited companies. Second, expensing will greatly decrease financial statement transparency and result in an apparent decrease in profitability (without any changes to the cash actually generated). The result will be an increased burden on the investor to evaluate, analyze, and compare companies. With most investors lacking the time or resources for such analysis and most companies lacking professional research support, the result will be greatly reduced interest in some of the most promising enterprises. Ultimately, we do not feel that expensing options is an appropriate response to the concerns raised by its proponents. Financial statements are not the appropriate response to management excesses or corporate governance issues. Moreover, the impact to venture-backed companies and investors will be significantly adverse. We urge you not to adopt the current proposal. Regards,

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