

Submitted via email to: director@fasb.org

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November 4, 2002

Robert H. Herz
Chairman
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Re: File Reference 1101-001

Dear Mr. Herz,

Thank you for the opportunity to comment on the Financial Accounting Standards Board (FASB) Exposure Draft issued on October 4, 2002, regarding accounting for stock options.

The Software & Information Industry Association (SIIA) is the principal trade association for the software and digital content industry. SIIA provides global services in government relations, business development, corporate education and intellectual property protection to more than 500 leading software and information companies. SIIA's membership consists of some of the largest and oldest technology enterprises in the world, as well as many smaller and newer companies.

SIIA supports FASB's efforts to amend SFAS 123 to provide additional methods of transition for companies that wish to adopt the fair value method of recording expenses relating to employee stock options. Additionally, we support FASB's efforts to make available to investors better and more frequent disclosure about the cost of employee stock options. However, while we concur with the main thrust of these recommendations, and we strongly support the need to provide investors with more accurate and timely information, we believe that what is missing from the discussion is an emphasis on developing a valuation model for employee stock options that provides consistent results and comparable information across companies and industry sectors. More flexibility and additional transparency alone will not necessarily provide investors with better or more meaningful information.

I. Black-Scholes is an Imperfect Model

It is widely recognized that the Black-Scholes model is imperfect in many respects. The assumption that future stock evolution is lognormal with a known volatility ignores transaction costs and market impact, and it assumes that trading can be carried out continuously. The fair value as estimated by pricing models does not accurately reflect the nature of the stock transaction, as this amount is not what is realized to the employee. That is, unlike publicly traded shares/options, an employee stock award does not include the ability to sell and receive the remaining time value—the employee will only realize the intrinsic value of the option on the date the award is exercised.

As a result, valuation using a modified option pricing model would often result in an overstatement of expense in the financial statements. Moreover, since the impact of outstanding stock options is already established in the diluted earnings per share (EPS) calculation, expensing the value through Black-Scholes and other traditional methods would double-count the cost by lowering income through recognition of the expense while increasing the number of shares outstanding in the EPS calculations.

II. Lack of Standardization in Valuation Methodologies Results

Given that SFAS 123 permits the use of Black-Scholes, or any other valuation models contingent on the coverage of six key variables, companies are currently striving to create new approaches to establish a fair market value for a restricted option, when no such value can accurately be estimated. Unfortunately, the choice of method, combined with the series of calculations that are company specific, often provides for a significant lack of consistency and uniformity in valuation.

From the perspective of an investor comparing the cost of stock options across different companies with different stock option plans and different variations of Black-Scholes, or another valuation method, the results are non-uniform and incomparable. The net result is that various companies are likely to arrive at different fair value calculations that are equally legitimate but are not meaningfully or uniformly comparable to the investor.

In conclusion, SIIA supports FASB taking these steps to improve investor information and to make it easier for companies to adopt the fair value method of stock option valuation, if they choose to do so. However, the current valuation methods force companies to predict the stock prices, a task that is technically impossible and destined to produce inaccuracy and inconsistency.

SIIA believe that FASB would be well served to further explore alternatives of stock option valuation that do not cause companies to accrue an expense that cannot be known today—just predicted—and that do not have the end result of over-reporting the value of employee stock options. Certainly, unless the current inadequate stock option valuation models are vastly improved, SIIA strongly believes that the intrinsic value method is the best method for providing valuable investor information, and that using such valuation models for accounting purposes would be ineffective and counterproductive.

Again, thank you for the opportunity to comment on these proposed changes. We look forward to working with you in the future to help serve the information interests of investors.

Sincerely,

Ken Wasch
President