



January 31, 2003

By email: director@fasb.org

Letter of Comment No: 151

File Reference: 1102-001

Date Received: 1-31-03

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

Re: **Invitation to Comment, Accounting for Stock-Based Compensation**

Dear Sirs & Madams:

The Biotechnology Industry Organization (BIO) desires to express its views on the Invitation to Comment, Accounting for Stock-Based Compensation: A Comparison of FASB Statement No. 123 (“Statement 123”), Accounting for Stock-Based Compensation, and Its Related Interpretations, and IASB Proposed IFRS, Share-Based Payment (“The Invitation to Comment”) dated November 18, 2002.

BIO, the national trade organization representing the biotechnology industry, represents more than 1,100 biotechnology companies, academic institutions, state biotechnology centers and related organizations in all 50 U.S. states.

The biotechnology industry, like many other growth sectors of the economy, uses broad-based employee stock option plans that are very important to the continued growth of our industry. Such plans are especially important as the industry continues to commercialize its products and needs to attract employees from other, more mature industries. BIO supports the notion that accurate, consistent and more frequent disclosures are needed by investor and other financial statement users.

Our primary concern with the Invitation to Comment is the reporting of the Black-Scholes Value of employee stock options. Our industry (and BIO's membership) is dominated by emerging growth companies that have highly volatile stocks, many with limited liquidity. In light of this, BIO does not support expense reporting of stock options in the income statement. Specifically, the Black-Scholes model was not designed and is inappropriate for valuing employee stock options. For volatile stocks, the model produces values that we believe are misleading to investors and other users of financial statements. Additionally, the Black-Scholes model does not take into account that employee stock options are not freely tradable and cannot be exercised in many situations because of blackout periods. BIO continues to believe that current reporting choices provided by Statement 123 are working and should continue. We would be happy to provide you with several examples of how the Black-Scholes Value, when applied to companies in our industry, can be very misleading to investors.

BIO is also interested in working with the FASB to assemble a group of knowledgeable Chief Financial Officers that would serve as an industry liaison on accounting issues which are unique to our industry. We would like to pursue how such a group could have a meaningful impact on developing accounting standards that are relevant and appropriate to our sector (or how existing standards should be applied in circumstances unique to our industry).

BIO's comments with respect to certain issues discussed in the Invitation to Comment follow. Adequate time was not allowed to analyze and respond to each question. For your convenience, this letter has been organized to list each issue we are responding to in bold text, followed by BIO's response.

Issue 1: Statement 123 provides a scope exclusion for ESOPs and certain ESPPs, and the Proposed IFRS does not. Which view do you support and why?

The scope exclusion for ESOPs and ESPPs should remain as existing guidance in Statement 123 and SOP 93-6 addresses the accounting for these unique plans. Specifically related to ESPPs that meet the existing criteria in Statement 123, it is our opinion that these transactions are purchases of common stock by employees at fair value and therefore should be excluded from the guidance scope.

Issue 2(a): Do you believe that an accounting standard should mandate the use of an option-pricing model for measurement purposes? If not, what other Financial Accounting Standards Board

approaches do you believe would provide more consistent and reliable estimates of the fair value of employee stock options granted and why?

Issue 2(b): If you agree that an accounting standard should mandate the use of an option-pricing model, do you believe that a particular model should be mandated? If so, which model should be required to be used and why?

Issue 2(c): If you agree that an accounting standard should not mandate the use of a particular option-pricing model, do you believe that additional disclosures should be made to improve the user's ability to compare the reported financial results of different enterprises? If so, what types of additional information should be required to be disclosed?

Issue 2(d): Statement 123 and the Proposed IFRS require that certain modifications be made to the outcome of an option-pricing model to address certain features of employee stock options. If you believe that other modifications should be made to improve the consistency and reliability of those outcomes, please describe those modifications and why they should be required.

Issue 2(e): Do you believe that additional guidance for selecting the factors used in option-pricing models is necessary to provide added consistency and comparability of reported results? If so, what types of guidance should be provided and in which areas?

The accounting standard should require the use of an appropriate option-pricing model for footnote disclosure. The model used, including key assumptions and the basis for selecting a particular model, should be clearly disclosed in the footnotes. As described above, the Black-Scholes model often can produce misleading results for companies with stocks that are highly volatile and/or have limited liquidity. Under current guidance in Statement 123 there is limited quality guidance for determining the volatility assumption and no consideration of adjustments in value for companies with thinly traded stocks. Adjustments need to be allowed for these factors to provide for a more accurate determination of fair value. Also, employee stock options are nontransferable and subject to forfeiture, which reduces value. These factors are not considered in existing models, leading to an overstatement of value. In addition, we believe the standard should permit the use of new, appropriate option-pricing models as they are introduced.

Issue 3: Do you believe that employee and non-employee transactions are distinct and therefore warrant different measurement dates for determining the fair value of equity instruments granted? If so, why? If not, why not?

Issue 4: Do you believe that the fair value of equity awards granted to non-employees that include performance conditions can be measured with sufficient reliability to justify a grant-date measurement method? If so, why? If not, why not?

In most cases our small and medium-sized members encounter in practice, there is very little distinction between employee transactions and non-employee transactions. In the case of these small and medium-sized companies, non-employee grants are generally to scientific advisory board (SAB) members and technical consultants. The structure and economics of these grants are similar to employee grants. These companies believe that the measurement date should be the same for both employee and non-employee grants and that fair value of these estimates can be obtained with the same degree of reliability as employee grants.

Issue 7: Do you believe that the effect of forfeiture should be incorporated into the estimate of fair value per equity instrument (IASB approach)? If so, why? If not, why not?

Issue 8: Should failure of an award holder to satisfy the conditions that entitle the holder to retain or receive the promised benefits affect the amount of compensation expense that should be recognized related to that reward? If so, why? If not, why not?

We have not had adequate time to analyze the IASB approach to forfeitures. While we see merit to the approach in providing estimates for forfeitures at the date of grant that eliminates large adjustments that can occur under existing U.S. Standards, such an approach could result in overstating compensation expense for companies that are not mature and that have large unanticipated reductions in force (10-50% RIF's are not uncommon in our sector during capital market downturns). We question how these RIF's could be anticipated in the IASB approach at date of grant.

Issue 9: Do you agree that the result of the IASB's approach to calculate the fair value of equity instruments of nonpublic entities would be closer to fair value than minimum value? If so, why? If not, why not?

There is no reasonable basis for estimating expected volatility for private companies. The IASB's suggested methods are guesses not estimates. It is unclear how net assets (book value) or prices of similar public companies could be acceptable estimates of fair value given that book value is not an estimate for fair value and comparison to companies that are not comparable is not reasonable (private to public). The profit approach is not applicable as most private companies in the sector have losses. Many of our companies believe that the minimum value approach provides the best available estimate of fair value.

Issue 10: Which of the two attribution methods described by the standards do you believe is more representationally faithful of the economics of stock-based compensation arrangements and why?

We believe the existing attribution method in Statement 123 is the most appropriate. The "unit-of-service" concept in the proposed IFRS is overly complex, will prove difficult to track, and will not yield estimates that are more accurate than the straight-line or graded vested methods under Statement 123.

Issue 14: Do you believe that the measurement-date criteria in Issue 96-18 accurately reflect the economics of transactions with nonemployees? If not, why not?

Many of our companies do not see the distinction between employee and non-employee grants and question whether the measurement-date criteria in 96-18 is appropriate. In many cases, the 96-18 model produces income statement results that are highly volatile and have much different compensation costs for grants that have economics comparable to employee grants.

Issue 15: Do you believe that all of the tax benefits derived from stock-based compensation arrangements should be recognized in the income statement? If so, why? If not, why not?

If stock-based compensation generates tax benefits, it seems appropriate to reflect all of the tax benefits derived from such arrangements in the income statement. We believe that this approach is more reflective of the economics of the transaction and more consistent with the recording of tax benefits in other types of transactions.

Issue 16: As discussed in paragraph 83 of this Invitation to Comment, the Proposed IFRS expands on the disclosure requirements in Statement 123. Do

you believe that those expanded disclosures would be more informative to users of financial statements? If so, why? If not, why not? (Which of the disclosure requirements should be eliminated or modified in that case?)

Issue 17: Please describe any additional disclosures that you believe should be required in order to inform a user of financial statements about the economics of stock-based compensation arrangements.

BIO continues to support improved disclosures that are meaningful to shareholders and users of the financial statements. The current concern is that the stock option disclosure could become too lengthy and complex for shareholders and other users of financial statements. We support the IASB's suggestion to provide additional disclosure surrounding key assumptions (volatility and vesting conditions). The suggestion in paragraph 84-86, with emphasis on the sensitivity analysis, doesn't seem to improve disclosure. We believe the following items are most useful to users of financial statements:

- Summaries of employee and executive options grants
- Year-to-date option activity
- Table of options with exercise prices above and below market price
- Calculation of potential dilutive effects of stock option grants

We appreciate the opportunity to offer these comments. If you have any questions regarding this letter, feel free to contact us at (202) 962-9200.

Sincerely,



Carl B. Feldbaum
President
Biotechnology Industry Organization