Letter of Comment No: 2804 File Reference: 1102-100

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From: Joanna Gallanter [joanna@vsplp.com]

Sent: Thursday, May 27, 2004 1:37 PM

To: Director - FASB

Cc: icdowling@nyca.org

Subject: File Reference No. 1102-100

May 27, 2004

To: director@fasb.org RE: File No. 1102-1000

Dear FASB Representatives:

I am the Managing Partner of a venture capital firm and serve on the boards of six private companies. In addition to my responsibilities as a director, I serve on the compensation committee of a number of these companies. I am also a director of the National Venture Capital Association. In these capacities, I have closely followed the dialogue surrounding FASB's Exposure Draft on share based payment. I continued to be concerned about the implications for emerging privately held entities.

The valuation and reporting methodology put forth in the exposure draft are troublesome.

For emerging enterprises, the proposed fair value methodologies are problematic. I believe the current proposal would result in decreased financial transparency. In particular, the Exposure Draft requires companies to consider the extent to which "future experience is reasonably expected to differ from historical experience," effectively requiring companies to predict the impact of future volatility. The businesses that my firm invests in are often development stage enterprises. Winning or losing a single contract often has tremendous impact on the future of the company. In many cases we cannot reasonably predict future events. Given our own uncertainty, it is doubtful that auditing firms would be willing to sign off on emerging company financial statements.

Related to this concern, the Exposure Draft requires companies which are unable to estimate the fair value of employee stock options to use an "intrinsic value" methodology. This brings the stock price - an external factor over which management has no control - into the income statement. Further, if a company's value rises more than that of a competitor, it will be penalized with a larger expense. In periods when the valuation retreats, the expense may prove to be negative.

A further effect of the Exposure Draft is that it asks companies to reflect the impact of stock option grants on the income statement twice - once as an expense, and again as part of the fully-diluted share count. To my knowledge, this is unlike any other item on the income statement. Both investors and managers alike will be confused by this requirement.

In addition, the Exposure Draft requires companies to group employees in order to predict their behavior exercising stock options. This provision, once again, asks companies to predict the future. I question the ability of management teams and directors to accurately predict the behavior of groups of employees. Are compensation grades to be considered a group? Or do we group individuals of a certain sex, age or race? For managers of growth oriented enterprises, the exposure draft asks for the prediction of the behavior of certain unknown groups, among an infinite variety, in response to unknowable valuation changes.

The Exposure Draft fails to recognize the essential differences between employee stock options and those of freely tradable options. The current proposal is not workable in the "real" world and due to its reliance on future predictions creates a situation in which financial statements become unauditable. The proposal serves to make opaque the clarity which we need to exist in our financial reporting standards.

Thank you for your consideration of these issues.

Sincerely,

5/27/2004

