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Letter of Comment No: 2573
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From: Paul Felton [pjfelton@thv.net]
Sent: Tuesday, May 18, 2004 7:18 PM
To: Director - FASB
Cc: jcdowling@nvca.org
Subject: File Reference No. 1102-100

Dear FASB Members:

There are so many profound flaws in FASB's proposed rule regarding stock option expensing.

One of those profound flaws in this highly irresponsible proposal by FASB concerns the proposed valuation methodologies. These are so blatantly inadequate that FASB's "solution" amounts to medieval bloodletting to treat a patient with a rash.

What brings this all into such stark relief is none other than Warren Buffet, who is quoted below from his annual meeting in Omaha a few weeks ago on May 3rd. Since Warren Buffet and his partner Charlie Munger are probably the most widely cited supporters of this misbegotten rule, it is instructive to note their own words as transcribed from their recent annual meeting.

- "Black-Scholes model can lead to insane results. Then again, we like a certain amount of insanity."
- "I think what Charlie said last year is that for longer term options in particular, Black-Scholes can give some silly results. It misprices things."
- Black-Scholes is what I would call a "know-nothing" value system. If you don't know anything at all about value compared with price—in other words, if price is teaching you all that can be known—then the Black-Scholes model on a very short-term basis is a pretty good guess for what a 30-day option may be worth in some stock or another. The minute you get into the longer-term options where the know-nothing factor isn't so extreme, it's crazy to use Black-Scholes.

Ladies and gentlemen, if your most vocal advocate is deriding one of the mainstays of your proposal's methodology, you have a huge credibility gap.

FASB has every right to theorize about accounting, but unless you can rationally, consistently and credibly apply any accounting rule imposed by FASB, it is not responsible to promulgate it.

Sincerely,

Paul Felton
Trellis Health Ventures

5/19/2004