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Letter of Comment No: ZZ7

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Financial Accounting Standards Board MP&T Director – File Reference 1101-001 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

Re: Invitation to Comment on Accounting for Stock Options

Dear Sir or Madam:

The Electronics Manufacturing Services Group ("EMS Group") is hereby providing its comments on the *Invitation to Comment* on accounting for stock options, dated November 18, 2002 (the "Invitation"). Because the proposed changes will have a significant effect on the competitiveness of complying companies, compared with their Asian rivals, and because the changes will substantially reduce the clarity and comparability of reported financial results, we appreciate the opportunity to offer our insights.

As discussed below, there is no option-pricing model that is able to provide valuations without substantial judgment input by the company executives. Also, any form of expensing will reduce the perceived profitability of companies whose stock is traded on North American Stock Exchanges, and hence their ability to either attract talent (if they reduce options) or capital (if the retain options at present levels) will be severely impacted by this proposal.

Executive Summary

The EMS Group is comprised of the five largest electronics manufacturing services companies traded on U.S. exchanges. Together, these companies have over 260,000 employees.

We believe that the purpose of accounting rules is to ensure the transparency and comparability of financial results. With all the recent events stemming from poor Corporate Governance we urge FASB to concentrate on moving the accounting rules towards processes for which there is less judgment, less ambiguity, and more chance for uniformity between companies in a similar business.

Our specific points of view are:

- Mandated expensing of employee stock options is without reasonable accounting rationale.
- All the existing option pricing models, including Black-Scholes and binomial models, with the best judgment and adjustments, produce forecast results that have virtually no resemblance to actual results. These models were only designed to value freely tradable options. Mandated expensing will not improve financial statement transparency, comparability, or reliability.
- Stock Options are a capital event - they potentially reallocate stock ownership. They don't change the absolute value of resources that the corporation has generated for its stockholders. There is substantial empirical economic evidence indicating that the use of broad-based stock option plans actually increase the value of resources created for stockholders. The current method of accounting for options under APB 25 require the effects of this dilution in the calculation of earnings per share. This is a more appropriate reflection of the impact of options.

- Expensing options is likely to lead to a more distorted picture of a
 company's financial performance and condition. Mandated expensing
 will ensure that investors receive financial information that is highly
 subjective and easily manipulated.
- From surveys that have been performed by various entities, mandated expensing of employee stock options will eliminate broad-based stock option plans. Instead, they will be concentrated only on the more highly compensated employee group, such as management. North American companies will have to forego the productivity, innovation and economic growth generated by broad-based plans.
- As a general perspective on accounting rules, we urge FASB to enhance meaningful disclosures to help restore investor confidence. Meaningful, timely and investor-friendly disclosures that don't present sophisticated guesswork as reality is the best approach for accounting rules.

Value does not equal Cost

Those proposing the new rules do not seem to appreciate that Value and Cost are completely different in concept and substance. Simply looking at the many companies trading above their book value provides one indication that there is a difference. Furthermore, there are plenty of accounting rules associated with Acquisitions that address the premium value created by companies. While we can agree, therefore, that options have value to employees, even if we could reliably measure the value there is no direct link to the cost of the option. In fact, for most companies that issued options in the 1999-2000 period, the cost (in terms of dilution to existing

stockholders) of those options has thus far been zero, since most companies' stocks are trading well below the exercise values set in those years. With the layoffs that have incurred since those options were issued, many of the issued options never will have a cost. Yet the proposed mandatory expensing would include such option issuance as a cost to the corporation with no cost-recapture provision when the option is cancelled and no impact ever expected on the existing balance sheet of the corporation - - that is, no cash cost will ever be paid out by the corporation.

Although options do represent a benefit and value to employees, this is not sufficient reason to include it as an expense. For example, many employees take considerable value in working for well-recognized name-brand companies. Others take value in working for a company located close to their home. It would be foolish to attempt to characterize all things that benefit employees as costs to the corporation.

The harm of unnecessarily burdening companies with fictitious costs

As explained in the previous section, we do not believe that Employee Stock Options should be considered a corporate cost. Adding such an expense to the income statement of companies that raise capital in the United States will represent a severe penalty. By comparison, companies in the EMS Group compete regularly with Taiwanese manufacturing companies, which are able to issue stock well below market value to their employees while taking no charge to earnings for such activity. A review of the financial performance of such companies shows that they generally have been using nominally-priced stock grants as the major means of compensating their executives. These grants do not need to be expensed under Taiwanese accounting rules, and as a result, they are carrying virtually no costs on their income statements for their executives and senior managers. Never-the-less, they are able to raise capital at strong

price/earnings ratios from what would represent, in North America, inflated profit levels. It would be very unfortunate if companies raising capital in the United States are further penalized by the mandatory expensing of stock options.

Capital Instrument versus Compensation.

A number of studies have shown that Employee Stock Options are much more akin to a capital event than a compensation event. Rutgers University Professors Joseph Blasi and Douglas Kruse and Business Week Senior Editor Aaron Bernstein have recently documented clear empirical evidence that, contrary to the claims made by mandatory expensing advocates, employee stock options for non-executives are not compensation from an economic standpoint. They indicate that "There's substantial economic evidence that options bring workers capital rather than labor income". This should be no surprise, given that the widespread use of options began in Silicon Valley where public companies used options to compete for talent with the numerous Silicon Valley start-ups that enable new employees to invest, buying founding stock and working for below-market salary. Stock options not only align the interests of employees and investors, they make employees economic owners of the company. At the same time, the options they are granted do not represent a liability on the assets of the company. Thus, it is most reasonable to account for options as equity instruments whose sole accounting impact is to dilute the ownership of other investors.

Avoid Creating Another Way to Manipulate Earnings

With all the attention being paid to the corporate governance issues of the last year, it is extremely unfortunate that FASB is contemplating the introduction of mandatory expensing of stock options and thus introducing another means for corporations with ill-intent to manipulate their financial results. When the expense is based on one of the valuation models such as Black

Scholes, it is highly dependent on assumptions such as volatility. The companies comprising the EMS group, for example, have volatility in the range of 50 to 80 percent. A change of 10 points in the volatility assumption can change the "value" of the option by as much as 25%. Granting options when the stock price is temporarily depressed will also provide a lower measured value, while most employees would see such an action as providing an option with a higher value. Opportunities also exist to manipulate the valuation models with changes in option lives and various option-exercise pricing methods.

Further, the adoption of mandatory expensing of options will be yet another reason why companies will want to report, and investors will want to see, "pro-forma" earnings that exclude this non-cash expense. It is unfortunate that FASB proposes promulgating rules for expenses that investors do not want to see in the financial results.

Conclusion

Any expense computed using current option pricing models will disproportionately impact companies in highly volatile industries as well as those whose employees benefit from broad-based stock option plans. Such companies have been the drivers of economic growth in this country over the past 10 years. Mandatory expensing will reduce the competitiveness of North American companies compared to their Asian competitors. The true cost of options is borne by shareholders who only take the resultant dilution as their stock values appreciate. There is no actual cost incurred by the corporation itself.

Mandatory expensing will reduce the transparency of financial results, encouraging and abetting numerous activities to manipulate the results. It will further encourage the use of "Proforma" presentation of financial results.

We strongly urge the Board and the IASB to devote the time and resources necessary to focus on disclosure of relevant, comparable, and meaningful financial information. This will much better serve investors, better facilitate capital formation and economic growth, and improve the standing of generally accepted accounting principles as the measure of financial return.

Thank you for considering our views.

Sincerely,

Celestica

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Executive Vice President & CFO

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