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MP&T Director-File Reference 1102-001
Financial Accounting Standards Board

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Via e-mail to director@fasb.org (File Refer

Gentlemen:

In determining whether or not to require the recording of compensation expense with respect to employee stock options, the over-riding concern should be whose interests are served and how those interests are served.

If the concern is providing value to investors, virtually every institutional investor we have discussed this subject with is strongly opposed to expensing stock options for the obvious reasons that doing so would distort the economic reality to the shareholder while at the same time ensuring that comparability of financial statements will be negatively impacted. To provide comparability, these investors will now have to develop pro-forma presentations of earnings and PE ratios and the SECs goal of reducing pro-forma presentations will be frustrated – the users of the financial statements will do what the issuers cannot.

If the concern is how or whether to calm the political clamor, the FASB should consider whether it would be a relevant organization going forward or merely a reflection of, and a slave to misinformed public opinion. Further, the obvious political goal of reducing the options granted to employees will not have the intended affect in that the most likely change to options programs will be to restrict them more and more to a smaller number of highly compensated employees.

At the risk of repeating what thousands of others have already told you or will tell you, I will add to the debate the following commentary around the usual objections to the usual assertions.

- **Stock options represent an expense to the issuing company.**
 - The argument is made that because the employee benefits the company correspondingly has a cost. The truth is that the cost is one borne by the shareholder and one that is already reflected in the dilution of earnings per share. Adding a charge for a supposed compensation expense understates the earnings created by the management and employee group for the benefit of the shareholders. While shareholders should certainly be aware of and interested in the impact of this dilution, distorting the real-world earnings as reflected in the income statement is not the place to provide this information. Just as the investing public is more and more coming to understand the importance of cash earnings, with the resulting additional focus on the statement of cash flows, the FASB proposes making the income statement less useful with a contrived cost calculated in a manner no one can comprehend.
 - Different companies choose to motivate their employees in different ways. Some use cash incentive compensation plans; others use stock options; others still use a combination of these as well as other methods. Under the FASB's proposal to

expense stock options, two companies with identical financial performance but with differing weightings of cash and options-based compensation could report materially different views of earnings per share.

- **Investors need to understand the estimated value of options**
 - Under FAS 123, companies already disclose to financial statement users the estimated value of options, either as an expense or in a footnote to the income statement. This is appropriate treatment due to the dubiousness of treating options as an expense. Those companies that treat options as an expense typically do not have substantial options programs and the impact of such an expense usually is immaterial. For those companies for which such an expense would be material, footnote disclosure gives investors the opportunity to judge for themselves what impact options grants might have on the financial performance of the enterprise.

- **The compensation value of options can be reasonably estimated**
 - There has been no systematic study of the efficacy of the Black-Scholes model, or any other valuation model, when applied to long term, unvested, non-tradable employee options. The existing valuation models were developed to price very short-term, publicly traded options that are exercised on expiration. It is unlikely anyone can be found at this point that believes this is an appropriate method of valuing employee options. The volatility factor alone is enough to give pause to any thinking person. A small cap stock with high volatility has more valuable options under most pricing models, but an argument could easily be made that they are really less valuable as the volatility cuts both ways (and in recent years mainly in the direction of less valuable not more, a fact that is reflected in FASB's interest in penalizing companies that re-price options).
 - The existing valuation models require the use of estimates. Different companies will use different models and different estimates for the inputs to the models. Thus, it will be difficult, if not impossible to compare the financial statements of potentially similar companies.

In closing, I believe at a minimum that FASB should wait for IASB to complete its stock options accounting project before proceeding: The IASB is slated to complete its ongoing stock options accounting project at the end of this year. FASB should wait until the IASB project is complete and a final rule is in place before proceeding with its own project. This will eliminate the potential for variation between the IASB standard and a FASB standard.

Sincerely,

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