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Financial Accounting Standards Board  
401 Merritt 7  
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Letter of Comment No: 204  
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Ladies and Gentlemen:

We at the Patterson Dental Company submit our comments to **FASB's Invitation to Comment on Accounting for Stock-Based Compensation**. The FASB continues to pursue a Standard that carries more emotion with it than probably any other project that the FASB has ever addressed. That, in and of itself, should indicate to FASB that the accounting for stock options does not have a good answer. FASB reached a prudent and appropriate compromise on this matter when it originally issued Standard No. 123. In our view FASB No. 123 did not need to be issued because the existing APB 25 did an adequate job of dealing with the matter of stock options. But since FASB felt compelled to try to fix something that was not broken, at least they settled on a Standard that allowed both sides in the debate to move forward to more important endeavors. This issue, while very emotional, in reality has very little real importance to our economic system. The current political environment has afforded some the opportunity to bring this controversy center stage once again to consume more time and energy which creates no real value to shareholders. Let's get on with life.

Our position specifically on this matter is summarized in two points; one, the cash flow of an enterprise is the most important determinant in its ultimate success, and two, there is no accurate or adequate methodology to measure the cost of a stock option issued to an employee. We will briefly discuss each of these as we believe they relate to stock options issued by an enterprise.

Stock options are a requisite to employees and others that receive them. The recipients perceive a value to the stock option and the option can act as an incentive to achieve certain actions by the recipient. The enterprise benefits from the issuance of the stock option when a myriad of reactions and events all result in the enterprise generating more cash from the goods or services that it sells than the expenses it incurs to deliver those goods or services. If the excess cash flow is sufficient to provide a return to the shareholders and that cash flow is expected to continue to grow, the market rewards the enterprise by bidding up its stock price and the option takes on real economic value. In this process, the only direct cash that the stock option generates for the enterprise is that received upon the exercise of the option, if that ever occurs. The enterprise never has to

incur an economic outlay of cash as a result of issuing the option. It incurs only a minor opportunity cost with the option (assuming it was issued at the market price of the stock at the date of issuance). Since it has to wait several years to receive the exercise price, it has lost the time value of the use of the proceeds during the intervening years.

Should the enterprise be expected to try to measure the perceived value of the option to the recipient? We think not. That is impossible. In addition, the perceived value to the recipient is not the 'cost' to the enterprise for the option. Trying to measure this intangible stimulus, one which has no cash cost, is analogous to measuring the culture of the enterprise, or the atmosphere that its management and employees create which encourages the creative capabilities of the whole operation. The enterprise is not expected to 'account' for these latter types of values. Attempting to measure the cost of intangible and prospective success is impossible.

The financial results of an enterprise, as measured by its financial statements, should reflect, as reasonably as possible, the cash flow that the enterprise generates. This is an important element to the markets, and shareholders, in being able to assess the 'value' of the enterprise. But the financial statements will never be the absolute determinant of the enterprise's value. This is an exercise for the marketplace taking into account many more factors than just the financial statements of the enterprise. The financial statements are not, and never will be, an absolute measure of the value of an enterprise. Adding a non-cash expense such as that created by the expensing of stock options creates another confusing aspect that the markets will generally be required to remove in valuing the enterprise. In an attempt to create transparency and comparability, this proposal creates nothing but confusion. It adds more subjectivity to the financial results of the enterprise as discussed in the next point.

The second aspect of the accounting for stock options that we find extremely troublesome is the FASB's belief that certain mechanical measurement formulas, designed for a wholly different purpose, should be used to determine the hypothetical cost of an employee stock option. The major flaw here is that the formulas assume that there is an open market for employee stock options. Obviously there is not. The value of the option (if any) can only be realized by actually buying the stock of the enterprise, not by exchanging the option between a willing buyer and a willing seller. This latter definition of fair market value is endorsed by the FASB itself in most other accounting standards requiring such a measure. Until there is a valuation technique developed that is designed specifically for employee options, any measure of supposed cost to the enterprise is at best a guess, and potentially worse, it is an error.

By mandating the expensing of options, the FASB would create a non-cash expense to the operations of the enterprise that provides no less clarity and transparency than exists today. In fact it probably creates more confusion and less insight since most true valuations of an enterprise would involve determining the expected cash flow of the business. This non-cash expense would have to be removed in that process since it neither creates nor uses cash flow from operations. The value once determined is then divided by the existing ownership and potential ownership (including stock options that

are reasonably expected to be exercised) to convert it to an individual measure of value, i.e. the value per share. It is during this aspect of the valuation process that it is appropriate to measure the impact to the enterprise of the issuance of the stock option. Not by some subjective, artificial measure having a more confusing than enhancing effect on the financial statements of the enterprise.

Thank you for considering our comments.

Very truly yours,

R. Stephen Armstrong, Executive Vice President & Chief Financial Officer  
Patterson Dental Company