



#1 Information Way
Little Rock, AR 72202
www.acxiom.com

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MP&T Director - File Reference 1102-00
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Letter of Comment No: 220
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VIA EMAIL: director@fasb.org

Dear Sir or Madam:

Thank you for this opportunity to respond to your Invitation to Comment issued November 18, 2002, "Accounting for Stock-Based Compensation: A Comparison of FASB Statement No. 123, *Accounting for Stock-Based Compensation*, and Its Related Interpretations, and IASB Proposed IFRS, *Share-based Payment*." There are several issues in the Invitation to Comment that I would like to address, as well as other issues associated with stock options.

Before getting into specific issues identified in the Invitation to Comment, I would like to make a few general comments and express some of my opinions about expensing stock options:

- First, the true economic cost or impact to the company of issuing stock options is already reflected in the EPS calculation through dilution.
- Second, there is no real cost to the company above the dilution already reflected in EPS except for opportunity costs. Opportunity costs are normally not accounted for as an expense on the P&L.
- Third, in situations where options never vest or expire worthless due to bear markets or poor results from the company, there is no cost or affect on the company and no value delivered or realized by the employee as a result of the issuance of options. In these situations, it seems illogical that an earnings charge should be taken on the P&L.
- Fourth, if the expensing of options were made mandatory, there would be many situations where the P&L statement would be misleading and create confusion and misinformation rather than clarity. For instance, many companies who issued options at the height of the Internet bubble, with 5 year vesting, would still be showing large earnings charges this year for options that have no value and will likely expire worthless. How could that add clarity to financial statements?
- Fifth, the unintended negative consequences of forcing all companies to expense stock options would potentially be huge. This consequence could negatively impact the U.S. competitive advantage for innovation.
- Sixth, there are many companies, including Acxiom, that have implemented stock option programs which are designed to be advantageous to all shareholders. Our Company's

plan includes a six-year vesting period, with no vesting at all for the first two years, premium priced options (25% of each year's long-term incentive option grants to leaders are priced 25% above market on date of grant, and 25% are priced 50% above market on date of grant). The premium price features are designed to reward leadership only when the stock price grows significantly. Basically, our external shareholders get paid first. To penalize all employees and companies because a few have abused the stock option vehicle is an over reaction.

I understand and agree that the FASB should promote efforts to help restore confidence in American business, however, I believe that forcing all companies to expense stock options will do little to enhance corporate conduct or end accounting abuses. Stock options are not the problem and expensing them is not the solution. I believe this change would prove to be a short-sighted and ineffective measure and would create more harm than any possible good that would be created from this change.

Now, I would like to get into more specific issues regarding the methodology, rules and unintended consequences associated with a mandatory requirement to expense stock options.

Obviously, I am not in favor of such a requirement. However, if it is required, I would like to point out several problems, which should be corrected before implementing a requirement to expense stock options.

There are at least three specific issues that should be carefully evaluated before any changes are made to the current methodology of accounting for stock options.

1. No current option-pricing model can accommodate or ascribe a true or comparable value to the wide variety of options that exist.
2. The proposed methods of valuing stock options fail to reflect the true economic impact on the entity, rendering any accounting adjustment essentially meaningless.
3. Detailed disclosure requirements as proposed would only increase complexity, reduce transparency and overwhelm investors with information that is not comparable to or consistent with other entities.

The Black-Scholes options pricing model ("Black-Scholes") takes into account historical measures of volatility, current interest rates, time to expiration, strike price and current stock prices to set a value at a point in time. Predicting, much less accounting for, the actual value is not possible since future interest rates, volatility and underlying stock prices cannot be accurately forecasted. Accounting for an opportunity cost that is inherently unpredictable and impossible to measure renders current and future financial statements less reliable in reflecting option values, not more reliable. Comparability and transparency are negatively impacted with changes to the inputs to option valuation. There are too many dynamics and anomalies surrounding the large number of stock option plans existing in today's business world that prohibit any of the existing option pricing models from adequately valuing those options.

Since Black-Scholes is probably the most widely known and used, I would like to take a moment to point out a couple of its specific shortcomings. First of all, Black-Scholes assumes that employee stock options are freely tradable. However, this is not the case. Most stock options must be exercised by the option grantee or expire unexercised. Accordingly, a fairly significant discount from the derived value under Black-Scholes would be necessary to appropriately take into account the fact that employee stock options are not freely tradable.

Another issue with Black-Scholes is that the value derived under this model is predicated on the assumption that the value of the underlying stock increases over time and that historic volatility is imputed to be future volatility. In cases where stock prices have declined over an extended period of time, Black-Scholes has clearly been unable to accurately establish a true fair value for those options.

A third shortcoming with Black-Scholes is that there is no standard method of determining volatility. Volatility can be, and often is, the input that can most significantly affect the resultant value obtained under Black-Scholes, especially given the enormous volatility that has existed in the stock market during recent years. For example, using the three-year historical volatility of an underlying stock might be the most appropriate method of predicting future volatility of a three-year stock option. However, what data points should be used? The average monthly price for each of the last thirty-six months, the closing price at each month-end, the average weekly price for each of the last 156 weeks, etc.? In many cases, the resultant volatility of a stock will vary dramatically depending on which set of data points is used. As a result, more confusion and less transparency and clarity would now be a part of the option issuer's financial statements. I do not believe this result is what the FASB or the SEC wants in their constituents' financial statements.

There is also another point I would like to make regarding stock options before I discuss specific issues under the Invitation to Comment. I believe there is an inherent problem in companies recognizing compensation expense associated with stock options in cases where the value of the underlying stock declines below the strike price of the option and the option expires "out of the money" with no value and no effect on the company. Does an employee ever see any real value to options that are never "in the money"? Is the company impacted in any way for options issued, which expire worthless or never vest? Accordingly, why should a grantor be required to take a charge in its financial statements for something that has no value or cost to the company?

In addition, this accounting treatment seems to be inconsistent as compared to the treatment of non-vested options that are forfeited where previously recorded compensation expense is reversed upon forfeiture. Also, does recognizing compensation expense for these "under water" stock options really add clarity and transparency to financial statements? Take for example companies that issued stock options in the late 1990's when market valuations were, in many cases, significantly over valued. These companies would continue to incur significant amounts of noncash stock option compensation expense in their financial statements under the fair value method when the real value of their stock has declined substantially since that time. Any value that might have existed for the options tied to this stock has clearly vanished. Therefore, any charge included in the financial statements of such companies creates confusion, not transparency or clarity.

The first issue that I would like to address in the Invitation to Comment is Issue 2. Given the shortcomings of current option pricing models, I do not believe an accounting standard should mandate the use of any of the existing option pricing models. None of the currently available option pricing models gives a more accurate answer than do the others. Additionally, any future accounting standards that address stock-based compensation should provide additional guidance regarding the use of the most preferable option-pricing model to facilitate consistency and comparability among financial statements, specifically the volatility factors used in the model and how those volatility factors should be derived.

The next set of issues I would like to discuss includes several of the identified issues in the Invitation to Comment and primarily deals with the fundamental differences in the FASB 123 approach and the IASB approach to valuing stock-based compensation and the method of attribution of that derived value. It would seem to me that the underlying premise of accounting

for stock-based compensation using a fair value method and attributing that fair value to compensation expense of the issuing entity should be that the employees receive something of value (the stock options). In the event that the employee does not actually receive the options, the impact to the issuing entity's financial statements should be adjusted. Under the Statement

123 approach, the fact that an employee fails to fully vest with respect to stock options issued to that employee (i.e., forfeiture, etc.) is reflected in the entity's financial statements since all previously recognized compensation expense is reversed. The approach under the IASB method does not consider the fact that the employee never received anything of value because this method requires recognizing compensation expense using the units-of-service method. Therefore, assuming that using a fair value method of accounting for stock-based compensation is mandated by the FASB, I believe that the FASB 123 methodology is more appropriate and better reflects the economics surrounding stock-based compensation.

The final issue that I would like to comment upon is Issue 16 dealing with disclosures. The disclosure requirements under the IASB proposal go well beyond those required by Statement 123. Although these additional disclosures may provide additional insight to how companies measure and account for employee stock options, these disclosures will be complex and will reduce the understandability of financial statements for many users, particularly the requirements included in the 2nd, 3rd and 4th bullets of paragraph 83 of the Invitation to Comment. This is in direct conflict with increasing the transparency and clarity of financial statements. In addition, the additional disclosures will be extremely onerous for the issuers of financial statements, raising cost-benefit issues. Will any benefits provided by such additional disclosures outweigh the costs incurred to provide such disclosures? I do not believe they will. Accordingly, I suggest the FASB thoroughly consider the cost-benefit argument before incorporating any of the IASB disclosure requirements into any future modifications of Statement 123.

In closing, I would like to reiterate two important issues. First, I believe the FASB should delay any decision that mandates the use of a fair value method of accounting for stock-based compensation, recognizing the future valuation limitations that we discussed earlier and the negative impact to transparency and comparability. Also, any modification of Statement 123 should not include the expanded disclosure requirements included in the IASB proposal. Second, I am gravely concerned that premature adoption of mandatory accounting adjustments will result in significant changes in thousands of companies' business models. Growth companies use stock-based compensation in a much more significant manner than do non-growth companies. However, the proposed rules give no credence to such differences. Given the state of the current economy, the following questions must be answered: Do we need to force these companies to significantly modify their strategy on compensating employees, and what impact might this change have on our current fragile economy?

Thank you for your consideration of these comments.

Very truly yours,

Rodger S. Kline
Company Operations Leader
Axiom Corporation (ACXM)