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

As members of the biotechnology industry, we believe FAS 123 may have serious implications for the life sciences industry as well as for other entrepreneurial and high-growth sectors. FAS 123 is clearly biased towards companies in non-volatile industries and threatens to do the most damage to high-growth sectors. As such, mandatory expensing of stock options may have the unintended consequence of undermining the culture of entrepreneurship and innovation for which the US is known.

The goal of recognizing the "cost" of stock options has over-shot its mark and further effort must be spent in defining exactly what that cost is and who bears it. The issuance of stock options does not result in a corporate level cost that impacts net income. The "cost" of issuing employee stock options is borne by existing shareholders in the form of potential, future dilution. Confusing the value of a stock option to the employee with the cost to the corporation for issuing that option is the fundamental flaw with the rationale behind FAS 123. Expensing of stock options is effectively double counting, by recording the expense in the diluted EPS numerator and the dilution in the denominator.

Aside from the underlying rationale, numerous flaws exist with option pricing models.

- The impact on companies that are similar in virtually every way can vary greatly depending on the inputs used, with volatility having the greatest impact. Anticipating stock volatility is truly akin to trying to predict the future, not to mention interest rates, dividends, and employee behavior, which also have to be factored into the estimate.
- Certain aspects of current pricing models are particularly problematic in highly volatile sectors and as a result, companies with more volatile stock prices will incur a greater expense. Using current models, a charge still occurs even if stock price is the same as or lower than grant price. In addition, a higher stock price results in a greater charge.

- Current models assume that stock options are freely transferable. Employee stock options generally are not, and, given that an option with substantial restrictions is worth less than a freely tradable option, a discount for lack of transferability is essential to making pricing models more accurate.

If stock option expensing is to be broadly adopted, models for calculating the expense need to be greatly improved. One place to begin is to more closely link the actual benefit that the employee receives to the cost incurred by the company. Currently, there is no link between the accounting charge and the option exercise. Measurement occurs on day of grant without consideration of price during the vesting period. As such, companies in highly volatile industries stand to unnecessarily incur expenses that do not ultimately result in benefits to employees.

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