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March 7, 2003

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

Letter of Comment No: 241A  
File Reference: 1102-001  
Date Received: 3-7-03

Dear Board Members:

We are writing in response to the FASB's Invitation to Comment on accounting for stock options to express our concern that the process is basically flawed because the Invitation to Comment specifically directed respondents not to comment on whether stock options granted to employees result in compensation expense for the issuing company.

As many of the comment letters that have been submitted make clear, that is precisely the threshold question about which many experts disagree. It seems quite odd to us that you would want your respondents to pass over that crucial question. We would therefore urge the FASB – consistent with the historical commitment to due process – to carefully weigh the comments of those who nonetheless chose to address it.

Investors need accurate, reliable and meaningful information to make informed investment decisions. Accounting rules should reflect accounting principles that are generally accepted within the accounting profession, especially those that promote the disclosure, transparency, comparability and reliability of financial statements.

We believe a mandatory expensing standard – such as that proposed by the International Accounting Standards Board and apparently which is under consideration by the FASB – may not meet these important tests. Indeed, the comment letters submitted to the FASB thus far, as well as other materials on the public record, strongly suggest that a mandatory expensing standard will mislead investors with inaccurate information, skew the financial picture of companies (particularly those with volatile stock prices) and eviscerate broad-based stock options plans that are vital to economic productivity and employee advancement.

First, the mandated expensing of employee stock options is without any clear or generally accepted accounting rationale. The FASB has received more than 250 comment letters thus far, and it is clear that there are sharply differing views among accounting experts as to whether employee stock options should be counted as a cost that is deducted from earnings.

For example, a number of letters make the point that the real “cost” of employee stock options is, in fact, already accounted for and disclosed to investors through diluted earnings per share. Herman Miller, Inc., for example, commented that “an issuing company does not bear the ‘costs’ associated with stock options. Instead, the true cost results from the *potential* dilution in the

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ownership of existing shareholders” (emphasis in original). Similarly, the Association for Financial Professionals, which includes approximately 14,000 financial executives employed by more than 5,000 corporations and other organizations, commented that “[t]he cost of stock options is reflected in fully diluted earnings-per-share, under current accounting rules.”

“Generally Accepted Accounting Principles” should be exactly that – generally accepted. The record demonstrates that mandatory expensing is far from generally accepted among accounting experts and professionals. We believe investors care about dilution, and we support making information regarding dilution as accurate, prominent and investor-friendly as possible.

Second, a mandatory expensing standard will not give investors accurate or reliable information – instead, they will get exactly the opposite. The very nature of employee stock options makes it impossible to measure what they “cost” at the time they are granted. As a result, any mandatory expensing standard would inevitably rely on so-called option pricing models, the most well-known of which is the Black-Scholes model. The problem is that Black-Scholes was designed for options that are entirely different from employee stock options. It was developed for pricing publicly-traded, short-term stock options, not employee stock options. Increasing numbers of financial, accounting and economic experts and companies have voiced deep concerns that it is severely flawed when valuing long-term employee stock options that cannot be traded, sold or pledged.

Moreover, the Black-Scholes model, and others like it, are complex mathematical formulas that require a wide variety of subjective assumptions. This means that using such models to record charges to a company’s profit and loss statement would result in potential material misstatements of that company’s financial results – not more accurate and transparent financial reporting. Ironically, then, a mandatory expensing standard would undermine investor confidence, not raise it. As Harvard Professor William Sahlman wrote in his recent comment letter, “expensing options may lead to an even more distorted picture of a company’s economic condition than financial statements currently paint.”

Third, we are concerned that a mandatory expensing standard will inflict a fatal blow on broad-based stock option plans, which we believe should be encouraged, not eliminated. A number of experts and employee benefits practitioners have predicted that, if expensing were mandated, companies would cut back on all-employee plans, which would become much more “expensive” for working families in America.

We certainly support taking all necessary steps to punish senior executives who have abused stock options and betrayed investors’ trust. We should not, however, make the millions of hardworking and honest employees who have received, and continue to receive, stock options pay for the behavior of a few senior executives.

A recently published book, In the Company of Owners: The Truth About Stock Options (And Why Every Employee Should Have Them) includes extensive research showing that broad-based stock option plans, over the past 20 years, enhanced productivity, spurred capital formation and enhanced shareholder value. The authors, Rutgers University Professors Joseph Blasi and Douglas Kruse and *Business Week* senior writer Aaron Bernstein, describe the extraordinary

degree to which high-tech companies have "shared the wealth" with their employees, terming this "partnership capitalism." Their study of what they call the High Tech 100 – the 100 largest public companies that derive more than half their sales from the Internet – shows that employees hold a 19 percent ownership stake, which is more than the ownership stake held by senior executives.

This study and others demonstrate that the widespread employee ownership that defines broad-based stock option plans is good for workers, good for investors and good for the economy. As Staples wrote in its recent comment letter, "the role of stock options in the phenomenal growth and success of Staples cannot be overstated. From its founding, Staples has issued options as compensation for employees deep into the organization. These options, and in particular this egalitarian way of issuing them, were instrumental in providing the entrepreneurial incentive to create a \$12 billion company in only 15 years." We encourage the FASB not to adopt accounting standards that are likely to destroy this valuable tool.

Fourth, we commend the FASB for recently requiring companies to disclose more extensive information more frequently to investors regarding stock options. As noted above, we would support further efforts to require more investor-friendly information, particularly with respect to the impact of stock options on diluted earnings per share; the timing, volume and frequency of option grants to senior executives; the degree to which a company's stock option plan is broad-based; and other useful information. We believe that investors would be better served if the FASB continued down a path toward greater transparency and disclosure of accurate information, as opposed to adopting standards that rely on sophisticated guesswork at best. As you know, a number of the comment letters recently submitted supported a drive toward enhanced disclosure.

In sum, timely, accurate and meaningful disclosures, coupled with shareholder approval of all stock option plans, are the accounting and corporate governance reforms that, in our view, will best serve investors. They are far better than mandatory expensing which will effectively end the use of broad-based stock option plans and their ability to contribute to increases in productivity, the expansion of employee ownership, and to growing the economy.

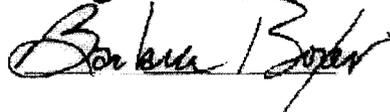
Thank you for considering our views.

Sincerely,

  
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John Warner

John Ensign

Jay Byrnes

Paul Ryan

Peter Dinkins

C. H. Fitch

Patty Murray

Harry Reid

Maria Cantwell

Debbie Stabenow

Paul Kenney