Letter of Comment No: 4145
File Reference: 1102-100

June 15, 2004

Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Re: Proposed Amendments to FAS 123

Dear Sir or Madam:

I am writing to you as a Managing Partner of Menlo Ventures, a Silicon Valley venture firm established in 1976 with over 2.7B under management, to express strong opposition to the proposal on accounting for employee stock options as currently drafted. **The proposal will negatively affect every company in our portfolio by increasing the cost and variability of financial accounting.** This will occur because of the inaccurate and variable metrics associated with expensing stock options per the proposed amendments to FAS 123. I would like to describe some of the negative ramifications these changes will have on our companies. Thank you for your time and consideration.

Determining costs and expenses within an emerging growth company is something a great importance due to lack of available and liquid funds. Due to the low threshold for error, the more concrete and efficient the process is, the better it is for both the bottom line of the company and the overall sustainability of emerging growth companies. The amendments to FAS 123 increase the cost and subjectivity to financial accounting by introducing added complexity in determining fair value, the Binomial Method, and required volatility assessment.

The "Fair Value" of a stock, as defined by "willing buyer, willing seller" is a perfectly valid assessment in terms of a publicly traded stock where there are a plethora of buyers and sellers who can determine the market value. For a private company where options have no trading history and are not available on the open market, the price of an option cannot be relied upon. It is invalid to determine fair value of an option in the absence of a fair value scenario.

The Binomial Method, i.e. the use of Binomial Trees for projection, is a viable method when each decision point can be resolve deterministically. However, if decision points are not statically quantifiable, as is the case for many emerging growth companies with assumptions regarding future earnings and growth, the Binomial Method only increases the amount of assumption by requiring binary decisions. This issue is analogous to the computer axiom "Garbage In, Garbage Out(GIGO)," meaning that if you rigidly attempt to make decisions based on assumptions, you will conclude an extremely wrong answer. By recommending the Binomial Method you are only increasing the likelihood of financial assessments becoming more skewed from reality. In addition, the laborious assumptions that the Binomial Method requires will increase the cost for financially strapped, emerging growth companies.

One of the key assumptions a start-up will be required to make is the stock volatility. It is virtually impossible to determine the volatility of a stock that is not publicly traded. There are no benchmarks and no underlying stock performance history, making an accurate calculation implausible.

In addition to the technical issues that negatively affect financial accounting both in validity and required cost to resolve, there are many broader economic issues that the proposed changes create. Two of the most important issues are a start-ups increased costs and decreased ability to recruit employees.

Emerging growth companies are a vital innovation engine for the industry in which they participate and the economy in general. Historically, start-ups have provided the R&D and technology innovation that drives the technology industry forward. This trend is more prevalent post economic downturn, since most large companies drastically reduce R&D during tech industry slowdowns.

To attract talented individuals with little to no name brand, start-ups often rely on stock options. **Stock options are a key component in a company's ability to retain top employees. Without stock options, many of today's innovative products would not exist because employees would not be willing to leave the comfort and security of a large, established company.**

The new standard negatively impacts emerging companies in comparison to more established companies, whether they continue to issue options or not. If emerging companies continue to issue options, the subsequent increase in cost could be the tipping point that causes a company to fail. On the other hand, if a company reduces the issuance of options to decrease costs, its best employees might never join the company due to lack of financial motivation.

The effect of the FASB's proposal will likely eliminate stock options for lower level employees in favor of key executives. In an effort to contain the damage to their income statements, companies are likely to ration their stock options, saving them for key positions where they are needed for competitive recruitment. This will most likely lead to less innovation, less productivity enhancements, slower growth and less employment.

While corporate accounting reform is a valid concern, the proposed changes to FAS 123 will cripple most emerging companies. For some, this will slow a company's growth due to a reduced ability to recruit top talent and increased accounting expenses. For others, these disadvantages will cause complete failure and the removal of these companies and products from the marketplace. In either case, the changes will negatively effect innovation and the economy as a whole. Menlo Ventures is committed to helping reduce accounting irregularities, but we urge you to reconsider the FASB's changes to FAS 123.

Sincerely,

H. DuBose Montgomery