Letter of Comment No: 3767 File Reference: 1102-100

June 14, 2004

Mr. Lawrence W. Smith

Director of Technical Application and Implementation Activities Financial Accounting Standards Board P.O. Box 5116 Norwalk, CT 06856-5116

RE: File Reference No. 1102-100

Dear Mr. Smith,

I am writing in response to the proposed Statement, *Share-Based Payment*. I have worked for a Big 4 accounting firm, I have been the Chief Accounting Officer of a public company and I am currently the acting Chief Financial Officer of a privately-held company. My comments are not based upon an allegiance to any particular organization but are based upon my desire for the FASB to establish financial and accounting standards that result in consistent and appropriate financial reporting among companies.

Based upon my review of the proposed Statement, I am greatly concerned with the inappropriate and inconsistent accounting and financial reporting that will result based upon this proposed Statement as well as the potential negative impact that could result to privately-held companies and their employees.

I have the following issues in regards to the proposed Statement:

- 1 Stock Options Should Not Be Expensed The economic impact of issuing stock options is already reflected in the financial statements. Stock options have a dilutive impact on earnings per share based upon their inclusion in the fully diluted share calculation when and if the options become valuable. Requiring companies to also include the estimated expense of stock options in their financial statements will result in a redundant impact to earnings per share calculations. Including the impact of stock options if they are outstanding and if they are in the money through the fully diluted share calculation is more appropriate than attempting to estimate the value of a non-tradable stock option.
- 2 No Accurate, Consistent, Reliable Way to Value Stock Options The FASB has not provided the tools and methodology for companies to consistently determine the estimated "value" of stock options. The stock option pricing models proposed to be used were developed to value options that are publicly traded almost all stock options of companies are not publicly traded and contain a substantial amount of restrictions. Furthermore, required inputs to the pricing models, such as the following, are very subjective and can result in very different stock option expense calculations across companies: Projecting future stock price volatility, projecting stock option exercise patterns of employees and projecting forfeiture rates of stock options. These inputs will

result in a significant amount of inconsistency across companies in determining the appropriate amount of expense to recognize.

- 3 Inconsistent Application Across Companies The inconsistent treatment between publicly-held companies and privately-held companies (and even among privately-held companies) will be detrimental to any benefit anticipated from this proposed Standard. First, privately-held companies have the option of using the Intrinsic Method versus the Fair Value Method. These methods result in drastically different amount of expense to the income statement over much different time periods. Although you encourage application of the Fair Value Method by privately-held companies, there will be great difficultly in defining the required inputs to a pricing model (i.e. the historical and future price volatility for a stock that does not trade publicly and the future stock option exercise patterns of employees) as well as getting approval of your independent auditor on the inputs utilized. Second, there can be significant differences in the transition rules across privately-held companies depending how they currently treat stock options for financial reporting. Isn't the objective of the FASB to ensure consistency of financial reporting across entities? These transition rules directly contradict this objective.
- 4 Extreme Administrative Costs The proposed Standard will result in significant administrative costs for companies. Monthly vesting for stock options granted in the high-tech industry is not unusual. The requirement to treat each vesting date of a stock option as a separate "grant" for fair value measurement could result in 40 to 50 different calculations for each stock option granted to an employee. This would result in significant time and effort being incurred to perform and audit the methods for determining stock option expense. It is vital that privately-held companies focus their limited resources on building a successful company not using their resources for administering an accounting standard that provides little benefit to shareholders, potential investors and employees.
- 5 Negative Impact on Privately-Held Companies It is vital for privately-held companies to be able to attract, hire and retain key employees. It is also necessary to align the employees' interests with those of shareholders. Stock options have been an important tool for achieving these objectives. Requiring privately-held companies to expense stock options will cloud their true financial performance and will likely result in decreased usage of stock options. This would negatively impact the ability for privately-held companies to succeed.

The resulting inconsistencies of the application of this proposed Standard would negatively impact the ability for most investors to accurately evaluate the financial performance of companies. Furthermore, most savy investors would back out any stock expense reported as there would be no way to determine a consistent comparison across companies. If the estimated expense of options must be reported, allow companies to continue to report this estimated expense and the basis for their estimates in footnotes to the financial statements rather than negatively impacting the consistency and accuracy of the face of the financial statements.

Privately-held companies drive innovation, increase productivity and stimulate the economy. Requiring the expensing of stock options would severely impact the success of privately-held companies by reducing the value of financial statements, increasing administrative costs and possibly terminating the use of stock option programs. This would result in a negative impact to America's competitiveness in the world economy.

I hope you will consider my comments when determining the appropriate course of action in regards to the proposed Statement.

Regards,

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