

To: FASB Directors
cc: Jennifer Connell Dowling, NVCA

Letter of Comment No: 2748
File Reference: 1102-100

Reference: File Reference No. 1102-100

Comments of James W. Breyer to the FASB Exposure Draft entitled *Share-Based Payment, and Amendment of FASB Statements No. 123 and 95.*

We have been active members of the venture capital community for over 20 years. I am a Partner of Accel Partners, a venture capital firm in Palo Alto, California. Our firm manages over \$3 billion in capital and has invested in more than 200 early stage companies in emerging markets during our 20-year history.

Our start-up companies have created literally tens of thousands of jobs and have developed entire categories in the global economy through their entrepreneurship, innovation and drive. In our view, one of the most critical elements in the model for success of these ground breaking companies is a broad-based stock option plan that delivers equity value to the broadest possible class of employee within the organization. The new accounting rules outlined in the Exposure Draft create disincentives to start ups that want to utilize employee stock options as a part of their business model. Eliminating or reducing the use of employee stock options would do a great deal of damage to the business model that has been so successful in the past.

In addition to the immeasurable impact on the economy that would result from a cutback in broad based employee stock option plans, there is also a considerable cost imposed by the proposed new rules in the form of (i) inaccuracies in financial reporting resulting from unreliable option valuation methodologies and (ii) substantial expense to prepare the new financial reports in the form of fees payable to accounting and valuation firms. These costs are an area of particular concern to private start up companies who are in less of a position to absorb costs and whose shares are very difficult to value using the proposed valuation methods.

The new guidelines call for the use of the Black-Scholes or the binomial valuation methodology. Both of these are complex formulations that have a tendency to create inconsistent results when applied across different companies in different industries over time. The problems are compounded when these formulas are applied to a private company that does not have freely tradable stock or readily available means to evaluate critical variables in the formulas such as stock volatility. Inaccurate, unauditable and effectively misleading financial statements result when a company uses unreliable estimates to complete these calculations. The inconsistency of these estimates, especially when applied to private companies, creates confusion rather than clarity in financial statements.

In an effort to address the concerns expressed in the preceding paragraph, the FASB has proposed the use of the "intrinsic value" method when it is not possible to estimate fair value. This methodology does not solve the problem. Using the intrinsic

value method a company would need to re-estimate its fair value each reporting period, resulting in inconsistency and compounding the use of unreliable estimates.

Since we all expect a company to exercise an appropriate amount of diligence and care when generating the estimates used in the formulas described above, a reasonable company would engage accountants, valuation firms and other experts to ensure that their estimates are in line with best industry practices and in compliance with the new rules. Although transparency is important, the time and expense required to prepare these unreliable disclosures outweighs the marginal benefits afforded by the disclosures that are the goal of the proposed new accounting rules.

Numerous experts have weighed in on the topic of whether expensing of stock options is appropriate, and many more have commented on what methodology should be used in the event they are to be expensed. Our view is that stock options are not a cost of doing business, do not affect revenue or operations, and consequently should not be factored into the profit and loss of an enterprise. Stock options reflect a movement in the ownership capital of a company and should not be shown as an expense in financial statements, or in a pro forma "as-if" disclosure.

If the FASB's judgment is different than ours, and it decides to implement some form of the proposed option expense regulations, then at a minimum it should consider providing an exemption from the new rules to private companies and to any broad based employee option pool. Employee stock options provide extraordinary economic benefits to the middle class worker, who, according to a study by Rutgers University, is the recipient of 94% of the stock options issued.

Sincerely,

James W. Breyer
Accel Partners