

Letter of Comment No: 5287 File Reference: 1102-100

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June 24, 2004

Director of Major Projects
File Reference No. 1102-100
Financial Accounting Standards Board
401 Merritt 7, P.O. Box 5116
Norwalk, CT 06856-5116

Via e-mail to: Director@fasb.org

cc: jcdowling@nvca.org

RE: Invitation to Comment regarding Exposure Draft, Share-Based Payment - an amendment of

Statements No. 123 and 95 (Proposed Statement of Financial Accounting Standards)

Dear Director of Major Projects:

This comment letter is on behalf of Centennial Ventures and is regarding our opposition to the exposure draft for Share-Based Payment.

Centennial Ventures was founded in 1982 and currently has over \$1 billion of assets under management. Since our inception, we have invested in over 120 private companies and almost every one of these enterprises is still operating or had a stock option program. Over the past twenty years, our portfolio companies have utilized stock option programs to recruit and retain thousands of employees. Additionally, we have found that stock option programs are an extremely effective way to align the interests of employees and shareholders to enhance enterprise value.

Centennial Ventures' opposition to the FASB's exposure draft for Share-Based Payments is detailed as follows:

Basic Accounting Principles

Employee stock options are not a compensation expense. Expenses are typically recognized when a liability is created or an outflow of cash occurs. An employee stock option does not satisfy either of these requirements. Secondarily, treating stock options as an expense does not satisfy the requirement that items included in financial statements be accurate, measurable, consistent, and comparable. Since employee stock options do not meet any of these criteria, they should not be considered as a component of the income statement. Finally, the proposed offsetting accounting entry to expense is a credit to paid-in-capital. While the aggregate impact, net of taxes, should be fairly neutral to shareholders equity, the increase to paid-in-capital is extremely misleading since it is offset by a reduction in retained earnings.

Valuation of Stock Options

The exposure draft falls short in determining the value of a stock option that is granted to an employee. As such it is not reasonable to expect a company to include the cost of a stock option in the income statement. Some of the more apparent valuation shortcomings include:

- Expenses should be based on fair value. Fair value cannot be determined for an employee stock option since the willing buyer, willing seller standard can not be met due to the restrictive nature of employee stock options. Accordingly, market prices for employee stock options do not exist.
- 2. The lack of a model to value employee stock options that considers the appropriate underlying attributes, such as trading restrictions, vesting, turnover, and employee behavior.
- 3. If an acceptable valuation methodology could be created, the exposure draft does not provide a basis to adjust the expense of a stock option using the valuation models to the value an employee actually receives.

Financial Impact of Stock Options

We believe that the underlying financial impact to a corporation from stock options is already reflected in the dilution to stockholders. The treasury stock method provides an adequate basis to compute the dilution of earnings per share from equity-based incentive programs. The exposure draft does not address the double impact on the earnings per share calculation of expensing options and also having additional shares outstanding.

Private Companies

The applicability of this exposure draft to private companies is even less compelling than it is to public companies. Modeling the value of an employee stock option for a private company has all the problems addressed for a public company. Additionally, the market for private equity shares is extremely restrictive, and a step discount factor for the lack of liquidity should be applied for valuations of private companies, which would indicate the value of employee stock options is nominal.

Compliance Matters

Most smaller companies are unable to comply with the proposed accounting due to the complexity of determining the expense of employee stock options using the proposed models. As such, it is likely that independent consultants will be engaged to determine the expense associated with stock options. For the private companies in which we invest, this is a poor use of cash, which is already a limited resource.

I appreciate the opportunity to comment on this significant accounting issue and hope you reconsider your position.

Sincerely,

Robert W. Keppler Chief Financial Officer

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