January 31, 2003

Financial Accounting Standards Board MP&T Director – File Reference 11012-001 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

Re: Invitation to Comment on Accounting for Stock Options

Dear Sir or Madam:

The Information Technology Industry Council (ITI) offers its comments on the Invitation to Comment on accounting for stock options, dated November 18, 2002. We appreciate the opportunity to offer our views on this important topic. The Information Technology Industry Council represents the leading U.S. providers of information technology products and services including computer hardware, software, networking equipment and Internet services. ITI's member companies produce over \$600 billion in annual worldwide revenues and employ more than one million people in the United States, a majority of which receive stock options.

ITI strongly supports efforts to ensure transparency, reliability and accuracy in financial reporting in order to best serve investors. However, we believe that existing option pricing models do not accurately or reliably compute the value of an employee stock option, and as a result, mandatory expensing would provide less accurate information to investors. ITI also feels that efforts to mandate expensing of stock options would curtail their use, which is contrary to public policy aims of employee ownership and robust economic growth.

Existing Option Pricing Models are Inaccurate

The ostensible purpose of mandated expensing of options is to provide more accurate information to investors, and increase their ability to make informed choices based on reliable financial data. We submit that mandated expensing of stock options as contemplated by IASB would thwart this goal. Investors will receive financial information from companies that they will accept as more detailed and accurate, when the opposite is the case.

Existing option pricing models, including Black-Scholes, produce inaccurate and misleading information. When included in a financial statement as an expense, as the IASB proposal seeks to mandate, readers will assume that this information is more accurate and dependable than it actually is, leading to greater confusion and misinformation than currently prevails.

Black-Sholes and other existing pricing models were designed to value freely tradable options, such as those for commodities. Employee stock options are

significantly more restricted than the options these models were developed to value. Employee stock options are generally not transferable, vest over time, and are subject to other exercise restrictions. These additional restrictions substantially change the nature and value of the option and greatly reduce the accuracy of valuations derived from existing models.

Existing pricing models also require an estimate of a stock's volatility, which essentially requires the modeler to predict the future. This volatility estimate is the most suspect value in the model, and also has the largest impact on the resulting valuation. A formula that puts the greatest weight on the most ambiguous and suspect input cannot be accurate and is bound to lead to more uncertainty than currently exists.

If expensing of options were mandated, companies could choose a variety of formulas to comply with the directive while making their corporate numbers most appealing. This multitude of formulas, and the great deal of leeway companies may be afforded to choose what numbers to use in whichever model they choose, will lead to myriad different valuations. Each will be substantially unique, chosen for the company's particular reasons, and will not lead to greater comparability. With no concrete regulations and guidance on how to compute their options, companies will necessarily offer widely divergent valuation systems. The investor will be left with worse information than under current rules where he or she is free to decide what the financial data means, and will not be given information that purports to be reliable and nonbiased when in fact the opposite may be true. Comparability and homogeneity (ostensibly one of the main purposes of the drive for expensing) will likely be reduced further than under the current system and it will cause more problems than it solves.

ITI and its member companies support efforts to increase transparency, reliability and accuracy of financial statements. Several ITI member companies have recently announced that they will voluntarily provide shareholders and the public with expanded information about employee stock options. The only "cost" of stock options may be in dilution of existing shares. The appropriate way to reflect that is through consistent and extensive disclosures of potential impact of employee stock options on earnings per share. ITI companies that have voluntarily agreed to provide greater disclosures will include specific information regarding the dilution existing shares by new grants of employee stock options. ITI feels that this is the proper course for increasing transparency and reliability in financial statements regarding employee stock options.

Expensing of Options is Contrary to the Public Policy Goals of Employee Ownership and Robust Economic Growth

Perhaps in no industry sector have shareholder, management and worker interests been aligned more closely than in our industry. This close alignment has been achieved by providing large numbers of employees with options. The majority of the over 1 million employees of ITI's member companies receive stock options, and the vast majority of stock options issued by tech companies are to rank-and-file employees, not

scnior executives. The high-tech community has been the leading user of employee stock option programs, and was the first industry to grant options to employees below the senior executive level. In particular, those entrepreneurial high-tech companies willing to take a risk in pursuit of technological innovation have offered stock options as an incentive to attract and retain employees.

Mandatory expensing of employee stock options will likely have the unfortunate side effect of curtailing their use. This will erode the progress toward employee ownership that the technology industry has led over the past decades. It will be economically damaging to growth in the technology sector and the U.S. economy. Finally, the curtailment of employee ownership through employee stock options will have the opposite effect from that which proponents of expensing seek: reduced corporate malfeasance and greater integrity in business performance.

According to a recent book by Dr. Joseph Blasi, Dr. Douglas Kruse and Aaron Bernstein, employee stock options enabled rank and file workers at the largest 100 Internet-based companies (which includes ITI members such as Amazon.com, AOL Time Warner, Cisco Systems, eBay, and Siebel Systems) to cash in an average of \$425,000 each in stock option profit in the 1990's. This is not senior executive compensation; it is low- and mid-level employees who were able to enrich themselves on the fruits of their hardwork and contribution to the success of their employer.

Mandated expensing of employee stock option plans will damage the broad-based plans now in place at most technology companies. According to Blasi, employee equity was 19 percent of the company in the High-Tech 100.⁴ That is a greater number than in any other industry, and rank-and-file workers owned more of the company than senior executives

Employee ownership also lifted productivity in those companies that offered stock options by 4 percentage points. Productivity is the central factor in generating economic growth, and raising living standards. High productivity growth allows strong economic growth without generating inflation. It has a significant impact on the Federal budget. It allows wage increases for workers and greater corporate profits without the need for price increases.

Employee stock options generate greater employee pride and concern for the company. They directly counteract the forces that have led to corporate malfeasance and corruption that is one of the main arguments for expensing. We think that mandatory expensing of options, by curtailing their use, will only increase the likelihood of further

¹ The percentage of stock options issued to rank-and-file employees at 4 ITI member companies Agilent Technologies – 93%

EBay - 85%

Intel – 97%

Sun Microsystems - 91%.

² In the Company of Owners. Blasi, Kruse and Bernstein. Basic Books, New York, NY. 2003.

³ Id.

⁴ Id.

Enron-like scenarios where employees and executives seek to enrich themselves at the expense of the company and the public. By increasing employee ownership, and the employees' stake in the company, stock options are a powerful force for good corporate behavior. Again, we feel that this proposal would create more problems than it would solve, while not solving the problems it purports to correct.

We have attached a wealth of employee testimonials from one of our member companies demonstrating the positive effect of employee stock options. These stories, from secretaries, bookkeepers and engineers, offer a valuable insight into what stock options mean to everyday people - and why widely distributed options have become such a valued tool for employers seeking to build and reward a loyal workforce. The likely result of mandatory expensing of stock options – curtailment of their use and availability – would deny a valuable resource to employers while limiting the ability of employees to build wealth through dedicated service.

Conclusion

ITI appreciates the opportunity to offer our views on FASB's invitation to comment on accounting for stock options. We support efforts to increase transparency, reliability and accuracy of financial statements and look forward to working with FASB to achieve that goal.

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Best Regards,

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Rhett Dawson President

⁵ See Appendix A.